Report No. 1421
September 4, 2019

The Honorable David J. Kautter
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable Michael J. Desmond
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
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Re: *Report No. 1421 – Report on Proposed Regulations relating to Section 897(l) (Exception for Interests Held by Foreign Pension Funds)*

Dear Messrs. Kautter, Rettig, and Desmond:

I am pleased to submit our Report No. 1421 commenting on the recently proposed regulations providing guidance on the exception from taxation under the Foreign Investment in Real Property Tax Act of 1980 for qualified foreign pension funds ("QFPFs") under Section 897(l). The Proposed Regulations provide much needed interpretative guidance with respect to the various statutory elements required to qualify for the exception for QFPFs.

We appreciate your consideration of our Report. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

Respectfully submitted,

Deborah L. Paul
Chair

Enclosure

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Report No. 1421

New York State Bar Association

Tax Section

Report on Proposed Regulations relating to Section 897(l) (Exception for Interests Held by Foreign Pension Funds)

September 4, 2019

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This report[1] of the New York State Bar Association Tax Section ("**Tax Section**") comments on the recently proposed regulations providing guidance on the exception from taxation under the Foreign Investment in Real Property Tax Act of 1980 (as amended, "**FIRPTA**") for qualified foreign pension funds ("**QFPFs**") under Section 897(l).[2]

The Proposed Regulations provide much needed interpretative guidance with respect to the various statutory elements required to qualify for the exception for QFPFs. We thank the Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**IRS**") for adopting many of the recommendations of the Tax Section and other commentators in response to the earlier request of Treasury and the IRS for comments on Section 897(l).[3]

This report is divided into three parts. Part I contains a general summary of our recommendations. Part II includes a brief summary of the QFPF exception and the Proposed Regulations. Part III sets forth our comments and recommendations with respect to these changes.

I. <u>SUMMARY OF RECOMMENDATIONS</u>

1. <u>Summary of changes to the Purpose Requirement</u>

a. Final regulations should make clear that an arrangement created pursuant to a foreign government mandate but in which private investment managers hold and invest contributions should be treated as "established" by the foreign government.

b. Request that final regulations define retirement and pension benefits

i. Final regulations should provide that retirement and pension benefits include a wide variety of arrangements that foreign countries may wish to make in structuring their retirement and pension systems, possibly looking to analogous provisions under ERISA, other provisions of the Code or international treaties.

ii. Final regulations should confirm that the recipient (or person designating the recipient) must have been employed and must be receiving the benefits by reason of his or her employment.

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[1] The principal author of this report is Marcy Geller, with substantial assistance from Edward Grais and Tyler Robbins. Significant contributions were made by Jonathan Brenner. Helpful comments were received from Richard Andersen, Kim Blanchard, Robert Cassanos, Jason Factor, Stephen Land, Richard Nugent, Deborah Paul, Michael Schler, Dana Trier and Libin Zhang. This letter reflects solely the views of the Tax Section of the New York State Bar Association ("**NYSBA**") and not those of the NYSBA Executive Committee or the House of Delegates.

[2] Exception for Interests Held by Foreign Pension Funds, 84 Fed. Reg. 26,605 (June 7, 2019) (the "**Proposed Regulations**"). All "Section" references are to the Internal Revenue Code of 1986, as amended (the "**Code**") or the Treasury Regulations promulgated thereunder.

[3] *See* PATH Act Changes to Section 1445, 81 Fed. Reg. 8398 (February 19, 2016) at 8399 (requesting comments regarding what regulations, if any, should be issued pursuant to section 897(l)(3)).

iii. Final regulations should provide that given that the definition of ancillary benefits is narrowly drafted, a QFPF should be permitted to provide a *de minimis* amount of benefits that are not within the enumerated categories and that the definition of "similar benefits" should be clarified.

iv. Treasury and the IRS should consider whether the 85% Purpose Component (as defined below) is more appropriately a safe harbor rather than a strict requirement. Further, if the 85% Purpose Component remains a strict requirement, we request greater clarity on the meaning of retirement and pension benefits.

v. Final regulations should contain some reprieve from strict yearly determinations under the 85% Purpose Component.

c. Final regulations should clarify inconsistencies in the reporting requirements under the Regulation Requirement (as defined below).

2. Withholding Issues

Final regulations should adopt a look-through rule for FIRPTA withholding when the seller is a foreign partnership

3. Ancillary Issues

a. Final regulations should provide that interests in a qualified controlled entity that do not entitle the holders to share in the income or assets of the qualified controlled entity are ignored in determining whether the qualified controlled entity is a qualified holder.

b. Treasury and the IRS should (i) consider implementing a tracing approach, either as the default treatment for entities that become QFPFs or qualified controlled entities or as an election, and (ii) consider implementing the mark-to-market approach as an election.

c. Final regulations should provide reprieve for an inadvertent loss of QFPF status due to the strict yearly determinations under the 85% Purpose Component.

d. Final regulations should explicitly provide whether a QFPF is considered a "foreign person" for purposes of determining whether a REIT or RIC (both as defined below) is "domestically controlled."

e. Treasury and the IRS should consider a private letter ruling program so that foreign pensions funds can seek certainty as to their QFPF status.

II. SUMMARY OF THE QFPF EXCEPTION AND PROPOSED REGULATIONS

Section 897(a) provides that gain or loss of a nonresident alien individual or foreign corporation from the disposition of a U.S. real property interest ("**USRPI**") shall be taken into account as if such gain or loss were effectively connected with the conduct of a trade or business in the United States during the relevant taxable year. Section 897(h) generally provides a look-through rule which subjects foreign investors in real estate investment trusts ("**REITs**") and regulated investment companies ("**RICs**") to taxation under Section 897(a) to the extent that distributions from such entities are attributable to gain from the sale or exchange of a USRPI.

Section 897(l)(1) provides that, for purposes of Section 897, a QFPF, or an entity all the interests of which are held by a QFPF, shall not be treated as a nonresident alien individual or foreign corporation, thereby exempting QFPFs from tax on gain from sale of interests in USRPIs, including REIT and RIC distributions treated as such gain under Section 897(h)(1). Section 897(l)(2) provides that a QFPF is any trust, corporation, or other organization or arrangement that meets a five-part test. First, the QFPF must be created or organized under the law of a country other than the United States (the "**Organization Requirement**"). Second, the QFPF must be established (i) by such country (or one or more political subdivisions thereof) to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (including self-employed individuals) or persons designated by such employees, as a result of services rendered by such employees to their employers, or (ii) by one or more employers to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (including self-employed individuals) or persons designated by such employees in consideration for services rendered by such employees to such employers (the "**Purpose Requirement**"). Third, the QFPF must not have a single participant or beneficiary with a right to more than five percent of its assets or income (the "**5% Participant Requirement**"). Fourth, the QFPF must be subject to government regulation, and annual information about its beneficiaries must be provided, or be otherwise available, to the relevant tax authorities in the country in which it is established or operates (the "**Regulation Requirement**"). Fifth, under the laws of the country in which the QFPF is established or operates, (i) contributions to the QFPF which would otherwise be subject to tax under such laws must be deductible or excluded from the gross income of the QFPF or taxed at a reduced rate, or (ii) taxation of any investment income of the QFPF must be deferred, or such income must be excluded from the gross income of the QFPF or be taxed at a reduced rate (the "**Preferential Tax Regime Requirement**").

The Proposed Regulations provide that the exception for QFPFs is available only to "**qualified holders**" and only to the extent that gain or loss otherwise taxable under FIRPTA is attributable to one or more "**qualified segregated accounts**" maintained by a qualified holder.[4] A qualified holder is generally defined as a QFPF or a "**qualified controlled entity**" (defined as a trust or corporation organized under the laws of a foreign country all the interests of which are held by one or more QFPFs, directly or indirectly through one or more qualified controlled entities or partnerships).[5] A "qualified segregated account" is an identifiable pool of assets

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[4] Prop. Treas. Reg. §§ 1.897(l)-1(b)(1), (2).

[5] Prop. Treas. Reg. § 1.897(l)-1(d)(9). It appears from the definition of "qualified controlled entity" that a partnership wholly owned by QFPFs would not itself be a qualified controlled entity. The Preamble notes that it is unnecessary to treat partnerships as qualified controlled entities because the Proposed Regulations' exemption from tax applies to gains and losses earned directly or indirectly through one or more partnerships. However, we note that in certain circumstances the exclusion of partnerships from the definition of "qualified controlled entity" may cause overwithholding. See "—Withholding Issues" below.

maintained for the sole purpose of funding "**qualified benefits**" to "**qualified recipients**."[6] The definitions of "qualified benefits" and "qualified recipients" are discussed further below.

The Proposed Regulations elaborate on and, in some circumstances, expand, the definition of a QFPF. Under the Proposed Regulations, a QFPF is defined as an "**eligible fund**" that meets the requirements of Prop. Treas. Reg. § 1.897(l)-1(c).[7] An eligible fund is a trust, corporation, or other organization or arrangement that maintains one or more qualified segregated accounts.[8] Prop. Treas. Reg. § 1.897(l)-1(c) implements the five-pronged definition of a QFPF contained in Section 897(l)(2) and provides that the Purpose Requirement, the 5% Participant Requirement, the Regulation Requirement and the Preferential Tax Regime Requirement are tested on an aggregate basis when the QFPF is an organization or arrangement that spans multiple entities. The Proposed Regulations also contain eight examples illustrating the application of these requirements.

In addition, the Proposed Regulations provide helpful rules relating to the exemption from withholding on payments to qualified holders under Section 1445. They provide that qualified holders may provide a Form W-8EXP to evidence their status as such and that income earned by a qualified holder that is exempt from FIRPTA under Section 897(l) will not be considered "effectively connected taxable income" (and subject to withholding) under Section 1446.[9]

III. RECOMMENDATIONS

1. The Purpose Requirement

a. *"Establishment" by a Foreign Government.* Consistent with the statute, the Proposed Regulations provide that an eligible fund must be established under foreign law by either the foreign country in which it is created or organized (or one or more political subdivisions thereof) or by one or more employers.[10] The Proposed Regulations do not elaborate on what it means for an eligible fund to be "established" by a foreign government. We believe that without further clarification, however, this "establishment" requirement may be understood to exclude the national pension systems of certain countries under which accounts in the names of individual participants are maintained by private entities. For instance, some foreign countries have pension systems in which all employees (or all employees working in a certain sector of the economy) are required by law to establish a pension account held and managed by a private pension administrator. Although this arrangement is created by government mandate, it is the private pension administrators who form the investment vehicles, select the investment advisors, and receive, invest and disburse the funds. Such arrangements are generally subject to

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6 Prop. Treas. Reg. § 1.897(l)-1(d)(13).

7 Prop. Treas. Reg. § 1.897(l)-1(d)(10).

8 Prop. Treas. Reg. § 1.897(l)-1(d)(2).

9 Prop. Treas. Reg. §§ 1.1445-2(b)(2)(v) and 1.1446-1(c)(2)(ii)(H). Note, however, that a Form W-8EXP will not affect withholding on a qualified holder's allocable share of partnership income that is ECTI under non-FIRPTA rules. Prop. Treas. Reg. § 1.1446-1(c)(2)(ii)(G).

10 Prop. Treas. Reg. § 1.897(l)-1(c)(2)(ii).

government regulation. Beyond regulation, the extent of government involvement varies, but may include the government being the conduit through which employers' and employees' contributions are funneled into the plans or benefits disbursed. It is unclear to us whether the Proposed Regulations would treat this arrangement as one "established" by the foreign government.

We believe it is appropriate to treat such an arrangement as "established" by the foreign government and that each private pension administrator, the investment vehicles that it establishes and any government office that is within the flow of funds should be treated as part of an "arrangement" that maintains qualified segregated accounts.

As we noted in our previous report, the policy of Section 897(l) is to include foreign pension systems that may not be structured in ways similar to ours.[11] Such systems may be legitimately structured in the way described above to benefit from the expertise of private investment managers. For instance, it is our understanding that many Latin American countries have adopted such a system as the form of their national pension systems.[12] We do not believe that Congress intended to exclude the national pension systems of such Latin American countries from the benefits of Section 897(l). Moreover, in the evaluation of whether an organization or arrangement is "established" by a foreign government, as long as individuals' participation in the pension system is mandatory, a requirement that contributions and benefits actually pass through government hands, or that funds be held or invested by the government itself, appears to us unnecessary. We therefore recommend that final regulations make clear that an arrangement created pursuant to a foreign government mandate but in which private investment managers hold and invest contributions should be treated as "established" by the foreign government and provide an example such as the following.

Example. Organization or Arrangement Created or Organized by a Foreign Country

Facts. Country X has enacted a comprehensive Pension Law covering all private sector employees, which is administered by the Pension Service, a government body of Country X. The Pension Law requires all such employees to enroll in a Retirement Plan offered by any one of several private Pension Administrators. All eligible Pension Administrators are licensed and regulated by Country X. Each Pension Administrator maintains one or more Investment Funds to hold the contributions with respect to the employees who have enrolled with that Pension Administrator. Each Investment Fund exists solely to fund qualified benefits. The Pension Law prescribes the eligible investments for these Investment Funds. Any private sector employee

[11] N.Y. ST. BA. ASS'N, TAX SEC., Report on Changes to FIRPTA under the Protecting Americans from Tax Hikes Act of 2015 (Rep. No. 1354, October 3, 2016) at 15 (citing legislative history).

[12] As one report notes, many Latin American countries use "fully-funded defined-benefit" systems, which "involve individual 'capitalization' accounts that are fed by mandatory saving contributions assessed on labor income. The savings thus accumulated are administered by private asset managers, typically known as *Administradores de Fondos de Pensiones* (AFPs)." *See* Augusto de la Torre and Heinz P. Rudolph, *The Troubled State of Pension Systems in Latin America*, Global Economy & Development Working Paper 112, Brookings Institution (March 2018) at 4. Such countries include Bolivia, Chile, Columbia, Costa Rica, the Dominican Republic, El Salvador, Mexico, Panama, Peru and Uruguay. *Id.*

who does not designate a Pension Administrator is assigned to a Pension Administrator and an Investment Fund by the Pension Service.

Contributions under the law are funded in part by employers and in part by employees. The law requires that all private employers withhold a portion of their employees' wages (representing the employee's contribution to the Retirement Plan) and pay such withheld amounts along with the employer's share of the contribution to the Investment Fund chosen by the employee and advised by the Pension Administrator with whom the employee is enrolled.

Upon retirement (as defined by the Pension Law), and at the election of the employee, benefits are paid out of the Investment Fund either in a lump sum, as an annuity, or by the distribution of an annuity contract purchased with the participant's balance in the Investment Fund from a licensed insurance company.

Analysis. The Retirement Plan offered by any given Pension Administrator and all Investment Funds maintained by such Pension Administrator constitute an "organization or arrangement." By virtue of the Pension Law's requirement that all private sector employees participate in a Retirement Plan, each Retirement Plan should be deemed to be "established by" the government of Country X.

b. *Benefit Thresholds.* Under the Purpose Requirement, an eligible fund, whether established by a government or private employer, must be established to provide retirement or pension benefits. Under the Proposed Regulations, to qualify as being established to provide retirement or pension benefits, an eligible fund must pass two tests: (i) all of the benefits that the eligible fund provides must be qualified benefits provided to qualified recipients (the "**100% Purpose Component**"); and (ii) at least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide must be retirement or pension benefits (the "**85% Purpose Component**").[13] "Qualified benefits" are retirement and pension benefits as well as benefits payable upon the diagnosis of a terminal illness, death benefits, disability benefits, medical benefits, unemployment benefits, or similar benefits (such benefits that are not retirement or pension benefits, "**ancillary benefits**").[14] The definition of "qualified recipients" depends on whether the eligible fund is established by a foreign government or a private employer. If the eligible fund is established by a foreign government, a qualified recipient is any person eligible to be treated as a participant or beneficiary of the eligible fund (or a person designated by such a participant or beneficiary to receive qualified benefits).[15] If the eligible fund is established by a private employer, a qualified recipient is a current or former employee (or a person designated by such employee to receive qualified benefits).[16]

i. *Definition of Retirement or Pension Benefits.* The Proposed Regulations do not define "retirement" or "pension" benefits. The preamble to the Proposed

[13] Prop. Treas. Reg. § 1.897(l)-1(c)(2)(ii)(B).

[14] Prop. Treas. Reg. §§ 1.897(l)-1(d)(8), (d)(1).

[15] Prop. Treas. Reg. § 1.897(l)-1(d)(12)(i)(A).

[16] Prop. Treas. Reg. § 1.897(l)-1(d)(12)(i)(B).

Regulations requests comments on whether final regulations should define retirement or pension benefits (for example, with reference to whether there are penalties for early withdrawal).[17]

As the definition of "retirement or pension benefits" is crucial to a taxpayer's assessment of whether it qualifies as a QFPF, we recommend that final regulations provide guidance on the meaning of that term. We recommend three possible sources to which Treasury and the IRS can refer in interpreting "retirement or pension benefits," namely, ERISA, U.S. federal income tax law under Chapter 1, Subchapter D of the Code and international tax treaties, many of which address the taxation of pension funds.

First, final regulations might look to the law under ERISA to interpret the term "retirement and pension benefits." For example, the definition of "pension plan" under ERISA refers explicitly to "retirement". Under ERISA, a pension plan is "any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that *by its express terms or as a result of surrounding circumstances* such plan, fund, or program (i) *provides retirement income to employees*, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan."[18] We understand that there is a substantial body of law under ERISA interpreting the terms "retirement" and "pension" benefits. We believe this makes the law under ERISA an appropriate point of reference for Treasury and IRS in providing taxpayers further guidance.

Second, final regulations might look to U.S. federal income tax law under Chapter 1, Subchapter D of the Code, which generally relates to retirement and pension arrangements that qualify for exemptions from U.S. federal income tax. We understand that these provisions have also required Treasury, the IRS and taxpayers to interpret what is a "retirement" or "pension" benefit. For instance, Treas. Reg. § 1.401-1(b)(1)(i) provides that a pension plan within the meaning of Section 401(a) is established "primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement."[19] That regulation also interprets the phrase "retirement benefit," providing that "retirement benefits generally are measured by, and based on, such factors as years of service and compensation received by the employees. The determination of the amount of retirement benefits and the contributions to provide such benefits are not dependent upon profits."[20] Treasury and the IRS might also look to the provisions of Subchapter D to provide an illustrative list of factors to be taken into account in deciding whether benefits are truly "retirement or pension benefits," for instance the exclusion from taxable income or the deductibility of contributions for the contributor (rather than for the eligible fund), limitations on contributions

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[17] 84 Fed. Reg. 26,605 at 26,609.

[18] 29 U.S.C. § 1002(2)(A)(emphasis added).

[19] Treas. Reg. § 1.401-1(b)(i).

[20] *Id*.

and benefits, rules governing minimum years of service requirements, as well as penalties for early withdrawal of funds.[21]

Third, alternatively, we recommend that Treasury and the IRS consider referring to the law and practice that has developed under international tax treaties. Many such treaties provide for the taxation of pension benefits and pension funds.[22] Moreover, law and practice under such treaties must necessarily take account of the variety of ways in which pension funds and benefits can be structured, making them an appropriate source of guidance in light of the goal of Section 897(l) to accommodate a variety of foreign pension fund arrangements.[23] The preamble to the Proposed Regulations notes that commentators requested that an entity that qualifies as a pension fund under a U.S. income tax treaty be automatically qualified as a QFPF. The preamble notes that such a result is inappropriate, as the definitions of pension fund under an income tax treaty are designed with policy goals unrelated to Section 897(l). We do not express a recommendation as to whether an entity qualifying as a pension fund under a U.S. income tax treaty should automatically qualify as a QFPF; nevertheless, given the inclusive policy of Section 897(l), we recommend that Treasury and the IRS consider referring to international law and practice to provide guidance on the meaning of "retirement or pension benefit."

We would caution, however, that final regulations should not simply require foreign pension funds to conform to U.S. requirements. The legislative history of Section 897(l) shows that Congress was aware that foreign pension funds may be structured differently from those in the U.S.[24] The 2018 technical amendments to the definition of QFPF further acknowledged such differences.[25] For example, the appropriate age of retirement may vary from country to country

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[21] *See* Sections 402 (contributed funds taxable to beneficiaries only on distribution), 410 (minimum participation requirements), 415 (limitations on contributions and benefits), 410(a) (rules governing minimum years of service requirements), and 72(t) (penalty for early withdrawals).

[22] *See, e.g.*, U.N. Model Treaty, art. 18(1), 2017 (alternatives A and B) ("pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State"); *Id*. art. 11(2)(e)(ii) (referring to "recognised pension funds"); OECD Model Treaty, art. 3(1)(i), 2017 (requiring that a "recognised pension fund" be "established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities" or to invest funds for the benefit of such entities or arrangements); Protocol Amending the Convention between The United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, art. 10(11), June 1, 2006 (defining "pension fund" for purposes of article on dividends as any person that "is established under the laws of a Contracting State; is established and maintained in that Contracting State primarily to administer or provide pensions or other similar remuneration, including social security payments, disability pensions and widow's pensions or to earn income for the benefit of one" and meets certain requirements of local law).

[23] 84 Fed. Reg. 26,605 at 26,612.

[24] *See* STAFF OF THE JOINT COMM. ON TAX'N, *General Explanation of Tax Legislation Enacted in 2015* (JSC-1-16) 283, 967 (2016) (noting that "[f]oreign pension funds may be structured in a variety of ways, and may comprise one or more separate entities."). *See also* preamble to the Proposed Regulations at 84 Fed. Reg. 26,605 at 26,608 ("[t]he Treasury Department and the IRS have determined that the purpose of [S]ection 897(l) is best served by permitting a broad range of structures to be eligible to be treated as a qualified foreign pension fund").

[25] *See* Pub. L. No. 115-141 § 101(q)(4)(A)-(B), Div. U (amending Section 897(l)(2)(E)(i) to include QFPFs the investment income of which is excluded from the QFPF's gross income, in addition to QFPFs the investment income of which is taxable at a reduced rate).

and we believe it would be inappropriate to require eligible funds to impose a particular minimum retirement age. The concept of withdrawal penalties, which the Proposed Regulations specifically mention, is similar; some countries may have such penalties, while others may consider such penalties inappropriate. We therefore recommend that whichever approach final regulations take, they define retirement and pension benefits to include a wide variety of arrangements that foreign countries may wish to make in structuring their retirement and pension systems.

ii. *Definition of Qualified Recipient.* For an eligible fund established by a foreign government, the Proposed Regulations define a qualified recipient as any person eligible to be treated as a participant or beneficiary of the eligible fund (or a person designated by such a participant or beneficiary to receive qualified benefits). Read literally, this appears to encompass anyone specified by the eligible fund's governing documents. Such a reading could expand the scope of Section 897(l) beyond pension funds to all government welfare schemes to the extent those schemes fulfill the requirements of the 85% Purpose Component (discussed below). We believe that this result is inadvertent. Section 897(l)(2)(B) refers specifically to benefits paid "as a result of services rendered by such employees" to their employers. Under the 85% Purpose Component test for qualified benefits, a certain portion of the present value of the eligible fund's benefits paid must be "retirement" or "pension" benefits. It appears implicit in the words "retirement" and "pension" that the recipient (or person designating the recipient) must have been employed and must be receiving the benefits by reason of his or her employment. We recommend that final regulations make this connection explicit.[26]

iii. *100% Purpose Component.* To implement the Purpose Requirement, the Proposed Regulations require that all of the benefits that the eligible fund provides be qualified benefits.[27] As noted above, qualified benefits are retirement and pension benefits as well as ancillary benefits (which are benefits payable upon the diagnosis of a terminal illness, death benefits, disability benefits, medical benefits, unemployment benefits, or similar benefits).[28] We note that given the definition of ancillary benefits, it appears that the provision of even a *de minimis* amount of benefits that are not within the enumerated categories would disqualify an eligible fund from being treated as a QFPF. For instance, the provision of housing or education benefits to employees and former employees, if not considered "similar benefits," might disqualify an eligible fund. We believe that a QFPF should be permitted to provide a *de minimis* amount of benefits that are not within the enumerated categories and we recommend that Treasury and the IRS consider whether such a result is appropriate and whether the definition of "similar benefits" should be clarified.

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[26] *See also* Prop. Treas. Reg. § 1.897(l)-1(e) Example 1. The facts of this example state that "Country A establishes Retirement Plan for the sole purpose of providing retirement benefits to all citizens of Country A aged 65 or older." Although the use of the word "retirement" suggests that the recipients (or persons designating the recipients) must have been employed, the use of the words "all citizens" leaves this unclear. The wording in the example might be changed so that the Retirement Plan provides retirement benefits to "all employed or formerly employed citizens of Country A aged 65 or older."

[27] Prop. Treas. Reg. § 1.897(l)-1(c)(2)(ii)(B).

[28] Prop. Treas. Reg. §§ 1.897(l)-1(d)(8), (d)(1).

iv. *85% Purpose Component.* In addition to the 100% Purpose Component discussed above, the Proposed Regulations require that at least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide must be retirement or pension benefits.[29] The 85% Purpose Component appears to interpret the statutory requirement in Section 897(l)(2)(B) that a QFPF be "established…to provide retirement or pension benefits" in order to distinguish between arrangements that are *bona fide* pension funds and arrangements that are not. As the preamble to the Proposed Regulations notes, this rule is meant to accommodate arrangements in which an eligible fund principally pays retirement and pension benefits but may also pay a relatively small amount of ancillary benefits.[30] The stated rationale for the 85% Purpose Component is that a specific limit on the percentage of ancillary benefits that an eligible fund may provide is more administrable and certain than a subjective standard. The preamble to the Proposed Regulations states that the choice of 85 percent as the threshold was made in part based on suggestions from commentators.[31] As we discuss further below, the choice of a bright-line threshold presents many practical issues for taxpayers in determining their status as a QFPF in a particular year.

Treasury and the IRS might have taken several other approaches in order to interpret the Purpose Requirement rather than the 85% Purpose Component. First, Treasury and the IRS might have adopted a facts-and-circumstances approach that asks whether a given arrangement was, under all the facts and circumstances, established to provide retirement or pension benefits. Such an approach would be consistent with the definition of "pension plan" under ERISA: "any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program (i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond."[32] Indeed, certain U.S. pension funds provide benefits that would be considered "ancillary benefits" under the Proposed Regulations.[33] Under this approach, as long as the arrangement actually was established to provide retirement and pension benefits, in light of all the facts and circumstances, the arrangement would fulfill this part of the Purpose Requirement, without the need for the 85% Purpose Component (such proposal, the "**Facts and Circumstances Proposal**").

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29 Prop. Treas. Reg. § 1.897(l)-1(c)(2)(ii)(B)(2).

30 84 Fed. Reg. 26,605 at 26,615.

31 *Id. See, e.g.*, Casse de dépôt et placement du Québec and Ivanhoé Cambridge Inc., *Comments on New Section 897(l) (Section 323 of the Protecting Americans from Tax Hikes Act of 2015)* (July 15, 2016) (IRS-2016-0006-0005) at 7.

32 29 U.S.C. § 1002(2)(A).

33 For example, the California State Teachers' Retirement System provides disability and survivor benefits. *See generally* California State Teachers' Retirement System, *Overview of the California State Teachers' Retirement System and Related Issues* (January 1, 2019), *available at* https://www.calstrs.com/sites/default/files/file-attachments/overview_2019.pdf (stating that "CalSTRS administers a hybrid retirement system, consisting of a traditional defined benefit, cash balance and defined contribution plan, as well as disability and survivor benefits"). Under the Proposed Regulations, disability benefits are among the enumerated categories of ancillary benefits and survivor benefits might also be considered "similar" benefits.

Second, Treasury and the IRS might have adopted a proration approach. For instance, a pension fund with the purpose of providing pension benefits might find in a given year that the present value of the retirement and pension benefits it expects to pay has fallen below 85 percent. Rather than disqualifying the entire pension fund, Treasury and the IRS might have adopted a rule allowing the plan to qualify as a QFPF in the same proportion as the present value of the retirement and pension benefits it reasonably expects to pay bear to the present value of all future benefits (such proposal, the "**Proration Proposal**").[34]

Third, Treasury and the IRS might have adopted the 85% Purpose Component as a safe harbor rather than a strict threshold. Pension funds that fall outside the 85% Purpose Component would then be required to show, in light of all the facts and circumstances, that they are, based on all the facts and circumstances, actually established to provide retirement and pension benefits (such proposal, the "**Safe Harbor Proposal**").

Although the remainder of our discussion focuses on the guidance taxpayers will need in determining whether they are compliant with the 85% Purpose Component as proposed, we recommend that Treasury and the IRS consider the approaches described above as alternatives to the 85% Purpose Component. Specifically, we recommend that Treasury and the IRS consider the Safe Harbor Proposal.

As discussed below, the use of a strict numerical threshold creates a cliff effect, which causes uncertainty as to whether a QFPF will qualify as such in future years. In addition, reliance on a numerical threshold would increase the importance of, and pressure on, guidance relating to the concept of a "retirement or pension" benefit. We believe that the Proposed Regulations could appropriately relieve this cliff effect by providing for a qualitative test as a fallback by which taxpayers can qualify as a QFPF. For instance, a qualitative test would be appropriate where a foreign taxpayer can show, from the books and records it keeps in the ordinary course of its operations, that it is a *bona fide* pension fund but does not normally keep books and records documenting compliance with the 85% Purpose Component .

We have considered the Proration Proposal and believe that it would not eliminate the difficulties of the 85% Purpose Component's strict numerical threshold, discussed further below, in classifying benefits as retirement benefits or ancillary benefits, measuring the funds attributable to each and documenting compliance. The Proration Approach would presumably require withholding certificates attesting to the appropriate proration. Withholding agents would be required to withhold on prorated portions of payments to such QFPFs and may not be able to rely on a previous year's proration in determining the current year's withholding, a result that we believe is unduly burdensome for withholding agents. Further, if such an approach were adopted it is not clear whether proration in the year of gain should be the relevant proration or rather a weighted average proration over the holding period of the asset. For these reasons, we do not recommend the Proration Proposal.

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[34] Under the Proposed Regulations, a QFPF would seem able to achieve this result by separating its assets into two segregated accounts. Nevertheless, there may be countries in which segregation of the assets is not feasible or desired. A proration approach could apply in such cases.

If Treasury and the IRS retain the 85% Purpose Component or adopt a similar strict numerical threshold, we recommend that they issue further specific guidance.

First, while a specific limit appears more administrable and certain than a subjective standard, the use of a present value calculation introduces uncertainty. We recommend that final regulations provide guidance on the assumptions that may be made in making the present value calculation. In particular, we believe it would be appropriate to require that present value be calculated in accordance with reasonable actuarial standards applied in good faith. Such a standard already appears in other areas of U.S. tax law. For instance, Section 431 requires that in determining minimum funding standards for multiemployer plans, all costs, liabilities, rates of interest and other factors must be determined on the basis of reasonable actuarial assumptions and must offer the actuary's best estimate of anticipated experience under the plan.[35]

Second, as discussed above, we believe that taxpayers need further guidance on the definitions of "retirement or pension benefits" in order to distinguish a retirement or pension benefit, on the one hand, from an ancillary benefit, on the other hand. Many benefits which otherwise might be ancillary benefits are often available principally to retirees, for instance medical and disability benefits. Such benefits may be thought of as retirement benefits and may indeed be administered by the same plans. Accordingly, we recommend that Treasury and the IRS consider whether, to alleviate the difficulties of line-drawing, certain benefits defined as ancillary benefits under the Proposed Regulations should instead be treated as retirement or pension benefits.[36]

v. *Year to Year Changes in QFPF Status.* We are as concerned as Treasury and the IRS that the Proposed Regulations' approach to the Purpose Requirement currently requires a yearly determination and that a pension fund's eligibility for Section 897(l) may change from year to year.[37] As discussed below, a yearly determination creates a severe cliff effect, putting pressure on the measurement of benefits, and raises issues under the 10-year anti-abuse rule (discussed below). We therefore recommend that Treasury and the IRS provide a degree of relief from year-to-year changes in QFPF status.

Yearly testing of the 85% Purpose Component creates a cliff effect that can lead to disqualification as a QFPF for reasons not entirely within the taxpayer's control. For instance, as the population of qualified beneficiaries changes, or as broader social and demographic conditions change, the proportion of ancillary benefits paid may rise above 15 percent. While an eligible fund may eventually be able to make the changes necessary to regain compliance with

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35 Section 431(c)(3).

36 For instance, although disability benefits are considered ancillary benefits, some plans may commence an annuity based on, or pay out the balance of, a retirement account on the disability of the principal beneficiary. In our view this is properly considered an acceleration of a retirement or pension benefit rather than an ancillary benefit. Given that it is closely associated with disability, however, taxpayers may be uncertain about its classification.

37 84 Fed. Reg. 26,605 at 26,615 (stating that "[t]he Treasury Department and the IRS recognize that the threshold approach may result in a small number of foreign pension funds oscillating between qualifying and not qualifying on a year-to-year basis and that such approach requires measurement of ancillary benefits relative to retirement and pension benefits"). We note that Section 897(l)(2)(B) does not explicitly require a yearly determination of whether a QFPF is established "to provide retirement or pension benefits."

the 85% Purpose Component, it would seem arbitrary to disqualify the eligible fund in the intervening years.

Such uncertainty would likely discourage QFPFs from investing in the U.S. In our experience, QFPFs' investments in U.S. real property typically span many years. Although a QFPF may be certain to qualify this year and the next, it may not be certain that it will qualify throughout the life of an investment. In addition, as we discuss further below, the year-to-year oscillation of a foreign pension fund's status as a QFPF may have severe adverse consequences for the qualification of its controlled entities as qualified controlled entities under the Proposed Regulations' 10-year anti-avoidance rule.[38]

We therefore recommend that final regulations contain some reprieve from strict yearly determinations under the 85% Purpose Component.

There are various ways in which Treasury and the IRS might provide for such a reprieve. First, the Treasury or IRS could provide a look-back rule to allow eligible funds to calculate compliance with the 85% Purpose Component over a multi-year period, rather than on an annual basis.[39] Second, Treasury and the IRS might provide for a grace period in which the QFPF can regain compliance without losing its exempt status. For instance, a QFPF that has been compliant for three consecutive years may be deemed compliant for the fourth year, so that if it would otherwise fail to qualify during the fourth year, it has a one-year grace period in which to regain compliance. Finally, Treasury and the IRS might consider making the QFPF partially ineligible for Section 897 to the extent the present value of the ancillary benefits it reasonably expects to pay exceeds 15 percent in a particular year (similar to the Proration Proposal).

While we do not recommend one approach over the others, we do recommend that Treasury and the IRS consider providing for at least one of them rather than a simple cliff effect at the time a QFPF no longer meets the requirements of this part of the Purpose Requirement.

2. <u>The Regulation Requirement</u>

Under the Regulation Requirement, the eligible fund must be subject to government regulation and annual information about its beneficiaries must be provided, or be otherwise available to, the relevant tax authorities in the country in which it is established or operates. The Proposed Regulations provide several helpful rules relating to this requirement. Two of the rules, however, appear to be inadvertently inconsistent. On the one hand, the Proposed Regulations provide that an eligible fund is treated as satisfying the information reporting

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[38] *See* "—Ancillary Issues—10 Year Anti-Avoidance Rule" below.

[39] This approach would be analogous to the substantial presence test under Section 7701(b)(3), which tests an individual's presence in the United States over a trailing three year period. Section 7701(b)(3). Such an approach has also been suggested by commentators. *See, e.g.,* Casse de dépôt et placement du Québec and Ivanhoé Cambridge Inc., *supra* n. 25 at n. 9 ("[t]he 85% determination could be made by looking at the average investments and income allocations as of the close of the prior three taxable years of the relevant fund or arrangement"); Association of Superannuation Funds of Australia, *Request for Regulatory Guidance under section 323 of the Protecting Americans from Tax Hikes Act of 2015 ("PATH Act") on the definition of "Qualified Foreign Pension Fund"* (July 21, 2016) (IRS-2016-0012-0051) at 3 (recommending a 70 percent threshold "applied based on an average over a period of three years").

requirement *only if* it annually provides to the relevant tax authorities the amount of qualified benefits provided to each qualified recipient (or such information is otherwise available to the relevant tax authorities).[40] On the other hand, the Proposed Regulations also treat an eligible fund as satisfying the information reporting requirement *if* it is required under foreign law to provide such information to one or more governmental units (or such information is otherwise available to one or more governmental units).[41] These two requirements are in conflict when an eligible fund is required by foreign law to provide such information (fulfilling the "if" condition) but does not actually provide such information (not fulfilling the "only if" condition). We recommend that Treasury and the IRS clarify the intended relationship between these two conditions.

3. Withholding Issues

The Proposed Regulations provide that an eligible fund must be a trust, corporation, or other organization or arrangement, but they do not address partnerships. This omission appears intentional. The preamble notes that Treasury and the IRS "have determined that it is unnecessary to treat partnerships as qualified controlled entities because the proposed regulations' exemption from section 897(a) applies to gain or loss earned indirectly through one or more partnerships."[42] However, we believe that this approach may result in overwithholding in certain circumstances. Although the Proposed Regulations provide that FIRPTA withholding will not apply to an eligible fund if it sells a USRPI directly, neither the Proposed Regulations nor the current Section 1445 regulations provides a look-through rule for sales by partnerships. Accordingly, a foreign partnership will be subject to FIRPTA withholding even if all of its partners are qualified holders under the Proposed Regulations because the partnership itself is not a qualified holder. By contrast, a foreign corporation all the holders of which are qualified holders will not be subject to FIRPTA withholding because the corporation will be a qualified controlled entity. If the selling partnership that is wholly owned by qualified holders were domestic rather than foreign, the seller would not be required to withhold under FIRPTA (as the transferee is not foreign) and there would be no withholding under Section 1446(a) under recently proposed regulations.[43] We recommend that Treasury and the IRS adopt a look-through rule for FIRPTA withholding when the seller is a foreign partnership to avoid these disparate results in almost identical situations.[44] The proposed regulations that implement the withholding regime under Section 1446(f) include a form of look-through rule that could provide a template for such a provision.[45]

4. Ancillary Issues

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[40] Prop. Treas. Reg. § 1.897(l)-1(c)(2)(iv)(B).

[41] Prop. Treas. Reg. § 1.897(l)-1(c)(2)(iv)(C).

[42] 84 Fed. Reg. 26,605 at 26,607.

[43] *See* Gain or Loss of Foreign Persons From Sale or Exchange of Certain Partnership Interests, 83 Fed. Reg. 66674 (December 27, 2018).

[44] We note as well that a similar issue exists for U.S. persons and foreign governments (as defined in Section 892) investing in USPRIs through a foreign partnership.

[45] *See* Prop. Treas. Reg. §§ 1446(f)-2(c)(2)(iv) and 1.1446(f)-4(c)(2)(ii).

a. *De Minimis Ownership of Qualified Controlled Entities.* Section 897(l)(1) provides that an entity all the interests of which are held by a QFPF shall be treated as a QFPF. In response to comments on the updated Section 1445 regulations, the Proposed Regulations apply Section 897(l) to a "qualified controlled entity" all the interests of which are owned by multiple QFPFs.[46] The Proposed Regulations define a qualified controlled entity as a trust or corporation organized under the laws of a foreign country all of the interests of which are held by one or more QFPFs directly or indirectly through one or more qualified controlled entities or partnerships.[47] The preamble to the Proposed Regulations makes clear that for this purpose, the relevant "interests" are interests other than interests solely as a creditor.[48] The preamble also explains that while Treasury and the IRS considered allowing for persons other than a QFPF to own *de minimis* interests in a qualified controlled entity, they determined that permitting such ownership would impermissibly expand the scope of the exception in Section 897(l) by allowing taxpayers other than QFPFs to avoid tax under FIRPTA.[49]

We agree with Treasury and the IRS that allowing ownership of the income and assets of a qualified controlled entity, even if *de minimis*, would open the Proposed Regulations to abuse. Nonetheless, we recommend that final regulations make clear that the ownership of non-economic interests in a qualified controlled entity is permissible. For example, a foreign partnership that elects to be treated as a corporation for U.S. federal income tax purposes may have a general partner that holds no economic interest in the entity. We believe that such fully non-economic interests do not present potential for abuse; moreover, accommodating such governance structures is consistent with the Congressional intent to include in Section 897(l) a large variety of foreign pension fund structures. A clarification, however, is necessary as such a non-economic interest is plausibly an interest other than an interest solely as a creditor. We recommend that final regulations provide that interests in a qualified controlled entity that do not entitle the holders to share in the income or assets of the qualified controlled entity should be ignored in determining whether the qualified controlled entity is a qualified holder.

b. *10 Year Anti Avoidance Rule.*

i. *Alternative Approaches*. The Proposed Regulations contain an anti-avoidance rule to address situations in which a foreign person sells to a QFPF a foreign corporation that in turn holds a USRPI. Without an anti-avoidance rule, the foreign corporation would qualify for the QFPF exemption from FIRPTA as a qualified controlled entity, allowing the built-in-gains that accumulated in the foreign corporation's hands to escape FIRPTA despite some or all of those built-in-gains having accumulated prior to the sale of the foreign corporation to the QFPF. The Proposed Regulations therefore provide that an eligible fund or qualified controlled entity is a qualified holder only if (i) it was a QFPF, a part of a QFPF, or a qualified controlled entity at all times during the applicable testing period, which is generally the 10-year period preceding the disposition of a USRPI or receipt of a distribution subject to FIRPTA (or

[46] Prop. Treas. Reg. §§ 1.897(l)-1(d)(9), (11).

[47] Prop. Treas. Reg. § 1.897(l)-1(d)(9).

[48] 84 Fed. Reg. 26,605 at 26,607-08. The preamble's explanation is based on Treas. Reg. § 1.897-1(d)(5), which defines "interest" to exclude creditor interests for purposes of Sections 897, 1445 and 6039C.

[49] 84 Fed. Reg. 26,605 at 26,608.

the period since December 18, 2015 or the period the entity has existed, whichever is shortest) or (ii) it held no USRPIs at the time it became a QFPF, a part of a QFPF, or a qualified controlled entity.[50]

The preamble to the Proposed Regulations explains that Treasury and the IRS considered two alternatives to the anti-avoidance rule in the Proposed Regulations.[51] Under the first alternative, the QFPF's acquisition of the foreign corporation would cause the foreign corporation to recognize gain or loss on its USRPIs (the "**mark-to-market approach**"). Under the second alternative, the foreign corporation would, after it became a qualified controlled entity, be required to trace any unrealized pre-acquisition gain, which would be subject to FIRPTA when recognized (the "**tracing approach**"). The preamble explains that Treasury and the IRS determined that either approach would impose greater compliance and administrative costs without any accompanying general economic benefit.

We recommend that Treasury and the IRS reconsider the second alternative, the tracing approach. Generally we agree that unrealized gain that accumulated in the hands of a non-QFPF foreign person should remain subject to FIRPTA for some time (for example, five years). However, appreciation in USRPIs acquired after a foreign entity qualifies as a QFPF or qualified controlled entity should be eligible for the QFPF exemption. The anti-avoidance rule in the current Proposed Regulations disqualifies the foreign entity entirely and appears to us to be overbroad for this purpose.

In the example above, under the anti-avoidance rule in the Proposed Regulations, to prevent tainting yet-to-be-acquired USRPIs, the QFPF must make future investments in such USRPIs through a different qualified controlled entity. Under the tracing approach, however, the QFPF could make new investments in USRPIs that would be eligible for the Section 897(l) exemption through the recently acquired qualified controlled entity. The tracing approach would tax only the built-in gain on the USRPI at the time the foreign corporation becomes a qualified controlled entity, which is analogous to other parts of the Code, for instance Sections 1374 and 337(d), which trace corporate-level tax on built-in gain when a C corporation converts to, or merges with, an S corporation, RIC or REIT.[52]

We also recommend that Treasury and the IRS consider allowing the mark-to-market approach as an election. We agree with the preamble to the Proposed Regulations that requiring the mark-to-market approach as the default regime would be unduly burdensome to QFPFs if the assets held by the QFPF are not easily valued; it would also likely deter QFPFs from investment in U.S. real property. However, there may be foreign entities and arrangements that would be willing to pay tax on the net unrealized gain built into its or its subsidiaries USRPIs. Allowing

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[50] Prop. Treas. Reg. §§ 1.897(l)-1(d)(11), (14).

[51] 84 Fed. Reg. 26,605 at 26,614-15.

[52] *See, e.g.*, Treas. Reg. § 1.337(d)-7 (tax on property owned by a C corporation that becomes property of a RIC or REIT). *See also* N.Y. ST. BA. ASS'N, TAX SEC., *Report on Final, Temporary and Proposed Regulations Under Section 337(d) Relating to Certain Transfers of Property to Regulated Investment Companies and Real Estate Investment Trusts* (Rep. No. 1382, October 10, 2017) at 12-21 (recommending a tracing approach to taxing built-in-gain in a "REIT spinoff").

such taxpayers to realize their net gains as a price for qualification as a QFPF would be consistent with limiting the benefits of Section 897(l) to gains properly attributable to QFPFs.

Accordingly, we recommend that Treasury and the IRS (i) consider implementing the tracing approach, either as the default treatment for entities that become QFPFs or qualified controlled entities or as an election, and (ii) consider implementing the mark-to-market approach as an election.

ii. *Tolling of Testing Period.* We agree with Treasury and the IRS that the situation in which a foreign person sells to a QFPF a foreign corporation that holds USRPIs is abusive and that an anti-avoidance rule is warranted to deal with that situation. However, we believe that the 10-year anti-avoidance rule as proposed is overbroad for this purpose.

In particular, the rule appears to disqualify QFPFs that fail to qualify as QFPFs at any time in the ten year look-back period, even if the failure has no potential for abuse or is even unintentional. Under the 10-year anti-avoidance rule, yearly testing of the Purpose Requirement and the possibility of year-to-year oscillation of a foreign pension fund's status as a QFPF may have severe consequences for the QFPF and its controlled entities. Controlled entities may cease to qualify as qualified controlled entities. A QFPF's or qualified controlled entity's disposition of a USRPI can be disqualified from the benefits of Section 897(l) if the entity failed to be a QFPF or qualified controlled entity at any time in the testing period, even if that failure is unrelated to avoidance of Section 897. For instance, suppose that in year 1 a QFPF acquires a USRPI. In year 5, it fails the 85% Purpose Component and loses its status as a QFPF but regains that status in year 6. In year 12 the QFPF sells the USRPI. Under the anti-avoidance rule as written, the 10 year period was reset beginning in year 6, and so the QFPF's disposition of the USRPI is ineligible for Section 897(l).

This result appears to be an unintended interaction of yearly determinations under the 85% Purpose Component and the anti-avoidance rule. In addition, it seems to us to be unduly harsh in light of the need for an entity to determine its qualification as a QFPF year-by-year. Accordingly, we recommend that Treasury and the IRS provide relief from the anti-avoidance rule for such temporary losses of QFPF status. First, Treasury and the IRS might provide for tolling of the 10-year testing period if a failure to qualify as a QFPF in one year is inadvertent and remedied in the following years. Second, Treasury and the IRS might provide for a tracing regime to apply to any appreciation in the QFPF's USRPIs allocable to the years in which it failed to qualify. Finally, Treasury and the IRS might provide for a mark-to-market election to allow a QFPF to purge such appreciation. We recommend that Treasury and the IRS provide for at least one of these methods of relief.

c. *Domestically Controlled REITs.* Section 897(h)(2) provides a special exemption from FIRPTA upon the sale of interests (either stock or securities) in a "domestically controlled" REIT or RIC. A REIT or RIC is domestically controlled if, at all times during the applicable testing period, less than 50 percent of the value of the stock is held directly or indirectly by foreign persons. "Foreign person" is currently defined for purposes of Section 897 in Treas. Reg. § 1.897-9T(c) as a nonresident alien individual, foreign corporation, foreign partnership, foreign trust or foreign estate.[53] Section 897(l)(1) provides that, for purposes of Section 897, a QFPF shall not be treated as a nonresident alien individual or foreign corporation. It is unclear whether a QFPF, which is not treated as a nonresident alien or foreign corporation for purposes of Section 897, is considered a "foreign person" under Section 897(h)(4)(B). By comparison, Section 1445(f)(3)(B) explicitly provides that a QFPF is not a "foreign person," but that determination applies only for purposes of Section 1445.

We recommend that Treasury and the IRS explicitly provide whether a QFPF is considered a "foreign person" for purposes of determining whether a REIT or RIC is domestically controlled. We note that if a QFPF is not considered a foreign person for that purpose, a REIT or RIC that is 51 percent owned by one or more QFPFs would be considered "domestically-controlled." It is not clear if the statute was intended to provide such a benefit as the legislative history does not discuss this result.

d. *PLR Applications.* We recommend that Treasury and the IRS consider allowing foreign entities that believe they are QFPFs or qualified controlled entities to apply for private letter rulings ("**PLRs**") on their qualification under Section 897(l). We appreciate the need for definite and administrable standards in final regulations to guide taxpayers and make the rules administrable, and we have recommended such standards in this report. However, we would also caution that given the wide range of possible arrangements under foreign law, the standards ultimately adopted may appear to exclude foreign entities and arrangements that any reasonable observer would consider to be a *bona fide* pension fund. Such entities would be more likely to take advantage of Section 897(l) if a PLR program were available. In addition, a PLR program would allow Treasury and the IRS to collect information on the organization and operation of foreign pension funds. Accordingly we recommend that Treasury and the IRS consider such a program.

[53] Treas. Reg. § 1.897-9T(c). When finalized, Treas. Reg. § 1.897-9T(c) will replace Treas. Reg. § 1.897-1(k), which is currently reserved.