



February 29, 2016

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## New Tax Benefit for Foreign Pension Plans Investing in the United States

New tax laws may be good news for foreign pension plans that invest in real property located in the United States. This article explains why pension plans that qualify for treatment under the new rules may discover tax benefits and simpler administration of the plans funds.

The Protecting Americans from Tax Hikes Act (the "PATH Act"), signed by President Obama on December 18, 2015,<sup>1</sup> changed the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") rules. First, consider how the FIRPTA rules might apply to foreign pension plans and next, evaluate how the PATH Act changes might affect those plans.

### FIRPTA Rules

Section 897(a) provides that non-resident alien individuals and foreign corporations are subject to U.S. income tax on the disposition of U.S. real property interests ("USRPIs").<sup>2</sup> A foreign trust is treated as a non-resident alien individual for this purpose and, thus, is subject to tax under section 897(a).<sup>3</sup> Foreign partners in a partnership (domestic or foreign) that owns USRPIs are subject to section 897(a) as if the foreign partners owned the USRPIs directly.

A disposition is any sale, exchange, transfer, or any other disposition under the Internal Revenue Code.<sup>4</sup> A USRPI is a direct interest in real property located in the United States or is an interest (other than solely as a creditor) in a domestic corporation whose assets consist of primarily U.S. real property.<sup>5</sup> U.S. tax treaties generally do not change FIRPTA rules.

<sup>1</sup> See Pub. L. 114-113, §§ 323 and 324. FIRPTA was made part of the Internal Revenue Code in the Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, § 1122(a).

<sup>2</sup> There are also special rules for distributions. For purposes of this article the disposition rules and distribution rules are the same.

<sup>3</sup> See section 641(b).

<sup>4</sup> See section 1.897-1(g).

<sup>5</sup> See section 897(c); see also sections 1.897-1(c-f), 1.897-2 (detailed rules defining USRPI).

Section 1445(a) applies a 15 percent withholding tax on any person that is a transferee of a USRPI, if the transferor of the USRPI is a “foreign person.”<sup>6</sup> The section 1445(a) withholding tax is a gross-basis tax computed by reference the fair market value of the transferred USRPI and is intended to be a surrogate for the section 897(a) tax that is due on the foreign transferor’s disposition of the USRPI. Prior to the PATH Act, “foreign person” for purposes of section 1445(a) was a non-resident alien individual, a foreign corporation, a foreign partnership, a foreign trust, or foreign estate.<sup>7</sup>

Thus, a foreign pension plan that is a foreign trust or is a foreign corporation is subject to FIRPTA tax under section 897(a). Similarly, foreign partners of a foreign pension plan that is a partnership are subject to FIRPTA tax under section 897(a). Finally, any person that acquires a USRPI from a foreign pension plan (whether a trust, corporation, or a partnership) is subject to 15 percent FIRPTA withholding under section 1445.

### PATH Act Changes to the FIRPTA Rules

Section 323 of the PATH Act amends the section 897 substantive FIRPTA provisions and the section 1445 FIRPTA withholding provisions for certain dispositions and distributions occurring after December 18, 2015. In particular section 323 creates new rules for certain foreign pension funds that are “qualified foreign pension funds” (“QFPFs”).<sup>8</sup> As QFPF that is a foreign trust or a foreign corporation is not subject to substantive FIRPTA tax under section 897.<sup>9</sup> In addition, the foreign partners of a QFPF that is a partnership are not subject to substantive FIRPTA tax under section 897.<sup>10</sup> A person who acquires a USRPI from a QFPF is not subject to section 1445 withholding tax.<sup>11</sup>

Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

<sup>6</sup> See section 1445(a), as amended by section 324(a) of the PATH Act (increasing the section 1445(a) withholding amount from 10 percent to 15 percent for dispositions occurring 60 days after the Path Act enactment).

<sup>7</sup> See section 1.1445-2(b)(2) (flush language), prior to regulatory changes with an effective date of February 19, 2016. T.D. 9751.

<sup>8</sup> See section 897(l), as amended by section 323(a) of the PATH Act.

<sup>9</sup> See *id.*

<sup>10</sup> See *id.*

<sup>11</sup> See section 1445(f)(3), as amended by section 323(b) of the PATH Act. See also section 1.1445-2(b)(2) (flush language) as amended by T.D. 9751.

A QFPF is a trust, corporation, or other organization or arrangement that satisfies rules designed to show that the pension trust or corporation is actually a pension plan covering a broad array of employees. These rules strongly resemble the Foreign Account Tax Compliance Act ("FATCA") rules, which in relevant part provide exemptions from FATCA withholding for certain qualified foreign retirement plans. At a high level, the qualifying conditions range from factors related to the regulatory environment in which the retirement plan operates to the specific profile of plan participants. Retirement plan administrators, particularly administrators who have not yet assessed their plan status for FATCA purposes, may face issues somewhat removed from their normal focus and may need help when applying the new rules.

The IRS has not yet moved forward with any specific guidance and has indicated that it may first ask for comments. So far there is little guidance on the interpretation of the rules.

The IRS has also not yet indicated a method for reporting, but the pension plan may need to certify (possibly on a Form W-8) that it is a QFPF, including representations that it meets the requisite individual conditions for QFPF status.

### Beneficiaries of the New Law

This change in the law can be significant for pension plans that meet the requirements, providing a better return on investment and simplifying administration of the plan funds. Other entities are also interested in this treatment. This rule potentially makes the U.S. real estate market more attractive for foreign investment, and may make entities with large U.S. real estate positions more likely investment targets for qualifying foreign pension plans.

### Qualifications for QFPF Status

To meet the QFPF rules, a plan must satisfy several requirements. Under the statute, a plan is a QFPF if it is trust, corporation or other organization/arrangement:

- Which is created or organized under the law of a country other than the United States,

- Which is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for services rendered,
- Which does not have a single participant or beneficiary with a right to more than 5 percent of its assets or income,
  - Which is subject to government regulation and provides annual information reporting about its beneficiaries to the relevant tax authorities in the country in which it is established or operates, and
  - With respect to which, under the laws of the country in which it is established or operates,
    - (1) Contributions to such organization or arrangement that would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or taxed at a reduced rate, or
    - (2) Taxation of any investment income of such organization or arrangement is deferred or such income is taxed at a reduced rate.

These requirements are not easy for some plans to satisfy, especially in certain countries—for example, where retirement plans mostly report to the local labor agency as opposed to the local revenue agency or where the labor market is relatively illiquid for highly compensated employees. These issues may not be readily apparent to plan administrators and investment companies.

## Conclusion

FATCA retirement plan determinations—both under the U.S. FATCA regulations and under the intergovernmental agreements entered between the United States and foreign jurisdictions—are strikingly similar to determinations pursuant to the new FIRTPA rules. It would be prudent

for taxpayers to take consistent positions for both and be able to reconcile and demonstrate any differences that may arise. Foreign pension plan administrators should be prepared to analyze the regulatory requirements now applicable to their plans. Thorough analysis, which concludes that plans are eligible for the benefits of the new law, would be a valuable asset for certain foreign pension plans.



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