



# TaxNewsFlash

United States



No. 2019-291  
June 6, 2019

## Proposed regulations: Exception for U.S. real property interests held by foreign pension funds (initial impressions)

The U.S. Treasury Department and IRS today released for publication in the Federal Register proposed regulations (REG-109826-17) regarding the section 897(l) exception from taxation with respect to a qualified foreign pension fund's gain or loss on the disposition of certain interests in United States real property.

The [proposed regulations](#) [PDF 394 KB] also include rules for certifying that a qualified foreign pension fund is not subject to withholding on certain dispositions of, and distributions with respect to, certain United States real property interests (USRPIs).

### Overview of proposed regulations

Section 897(l), added to the Code in 2015, provides an exemption to the application of section 897(a) on gain or loss on certain dispositions of, and distributions with respect to, USRPIs for certain foreign pension funds and their subsidiaries.

Section 897(l)(1) provides that a qualified pension fund or an entity all of the interests in which are held by a qualified foreign pension fund is not treated as a nonresident alien or foreign corporation for purposes of section 897 and, thus, is exempt from section 897(a) on gain or loss from the disposition of a USRPI or the receipt of a distribution described in section 897(h).

Section 897(l)(2) defines a qualified foreign pension fund as a trust, corporation, or other organization or arrangement that satisfies five requirements.

The proposed regulations provide guidance regarding:

- The scope of the exception described in section 897(l)(1)

- The application of the requirements described in section 897(l)(2) that an eligible fund must satisfy to be treated as a qualified foreign pension fund
- Rules regarding exemptions from withholding under section 1445 or section 1446

The proposed regulations are scheduled to appear in the Federal Register on June 7, 2019. Comments or requests for a public hearing are due 90 days after June 7, 2019.

### **KPMG observation**

The proposed regulations are viewed as generally providing helpful rules that generally interpret section 897(l) broadly and as providing foreign pension funds with greater certainty in determining qualified foreign pension fund status. The proposed regulations also provide a targeted anti-abuse rule.

### **Highlights of the proposed regulations**

#### ***Scope of the section 897(l) exemption***

- The proposed regulations clarify that the benefits of section 897(l) apply to trusts or corporations held directly or indirectly through one or more corporations or partnerships by a qualified foreign pension fund (such entities are referred to as “qualified controlled entities”). For example, if a qualified foreign pension fund wholly owns Foreign Subsidiary A and Foreign Subsidiary A wholly owns Foreign Subsidiary B, Foreign Subsidiary B will be a qualified controlled entity that is eligible for the benefits of section 897(l). This interpretation eliminates a hyper-technical anomaly in the relevant statutory language.
- The proposed regulations extend the benefits of section 897(l) to trusts and corporations wholly owned by multiple qualified foreign pension funds, either directly or indirectly through one or more qualified controlled entities.
- A creditor’s interest in an entity is not taken into account for purposes of determining whether the entity is wholly owned by qualified foreign pension funds or qualified controlled entities.
- The proposed regulations provide an anti-abuse rule that may deny the benefits of section 897(l) in situations when a qualified foreign pension fund or qualified controlled entity acquires a foreign entity that holds a USRPI. Specifically, the benefits of section 897(l) will not apply to any entity or governmental unit that, at any time during the testing period, was not a qualified foreign pension fund, a part of a qualified foreign pension fund, or a qualified controlled entity. For this purpose, the testing period is the shortest of: (1) the period beginning on the date that section 897(l) became effective (December 18, 2015) and ending on the date of a disposition described in section 897(a) or a distribution described in section 897(h); (2) the 10-year period ending on the date of the disposition or the distribution; or (3) the period during which the entity (or its predecessor) was in existence.
- The proposed regulations do not treat partnerships as qualified controlled entities. Only corporations and trusts may be treated as qualified controlled entities. The IRS and Treasury determined it was unnecessary to treat partnerships as qualified controlled entities because the proposed regulations provide an exemption from section 897(a) for gain or loss earned indirectly through one or more partnerships.

#### ***Requirements for qualified foreign pension fund status***

- The proposed regulations broadly interpret the phrase “organization or arrangement” to permit a broad range of structures to be treated as a qualified foreign pension fund.

- The proposed regulations clarify that a qualified foreign pension fund may include multi-employer pension funds, government-sponsored public pension funds, retirement or pension funds organized by a trade union, professional association, or similar group, and that a self-employed individual is treated as both an employer and employee.
- The proposed regulations allow a pension or retirement fund that provides other “ancillary benefits” (such as death, disability, survivor, medical, unemployment, and similar benefits) to qualify as a qualified foreign pension fund as long as 85% of the present value of the qualified benefits that the eligible fund reasonably expects to provide in the future are retirement or pension benefits.
- The proposed regulations clarify that a qualified foreign pension fund may be organized under the laws of a state, province, or political subdivision of a foreign country.
- The proposed regulations broadly interpret the phrase “organization or arrangement” to permit a broad range of structures to be treated as a qualified foreign pension fund.
- The proposed regulations extend qualified foreign pension fund eligibility to pensions organized under the laws of a country that does not have an income tax.
- The proposed regulations provide that a pension fund that does not report directly to a tax authority is treated as satisfying the reporting requirement in section 897(l)(2)(D) if the fund is required, pursuant to the laws of the foreign country in which it is established, to provide the required information to one or more governmental units of the foreign government, or if such information is otherwise available to one or more governmental units of the foreign country. The proposed regulations also provide that an eligible fund that is administered by a foreign government automatically is deemed to satisfy the reporting requirement.

#### ***Withholding under sections 1445 and 1446(a)***

- The preamble to the proposed regulations notes that the IRS intends to revise Form W-8EXP, *Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding and Reporting*, to permit qualified foreign pension funds and qualified controlled entities to certify their status under section 897(l) for purposes of both section 1445 and section 1446(a) withholding. The proposed regulations also allow qualified foreign pension funds and qualified controlled entities to avoid withholding under section 1445 and section 1446(a) by providing a non-foreign certification pursuant to rules similar to the rules in the current section 1445 regulations.
- The proposed regulations provide that for purposes of section 1446(a) withholding, a partnership’s gain from the disposition of a USRPI (or receipt of a distribution described in section 897(h)) that is not otherwise treated as effectively connected with a U.S. trade or business will not be treated as effectively connected taxable income to the extent allocable to a qualified foreign pension fund or qualified controlled entity.

#### **Effective date provisions**

The proposed regulations generally are proposed to apply to dispositions of USRPIs and distributions described in section 897(h) occurring on or after the date that the regulations finalizing the proposed regulations are published in the Federal Register. The anti-abuse provisions (discussed above) are proposed to apply to dispositions of USRPIs and distributions described in section 897(h) occurring on or after June 6, 2019 (presumably the date when the proposed regulations were filed for public inspection with the Federal Register).

The preamble states that a taxpayer may rely on the proposed regulations with respect to dispositions or distributions occurring on or after December 18, 2015, and prior to the effective date of the final regulations, provided that the taxpayer consistently and accurately complies with the rules in the proposed regulations.

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