

## Much-Awaited Modifications of Qualified Foreign Pension Fund Rules

*March 2018*

On Friday, March 23, 2018, President Trump signed into law the Consolidated Appropriations Act, 2018 (H.R. 1625) (the “2018 Act”). The 2018 Act is a \$1.3 trillion omnibus spending bill that includes several tax-related provisions.

Among other tax-related provisions, the 2018 Act provides some much-awaited clarification of the definition of a “qualified foreign pension fund” for purposes of Section 897 of the Internal Revenue Code (i.e., the “FIRPTA” rules).

The tax exemption for a “qualified foreign pension fund” under Section 897(l) was enacted in 2015. However, under the statutory language the availability of the tax exemption with respect to certain forms of foreign pension funds has been uncertain and no guidance has been published by the IRS or Treasury Department. Several foreign pension funds and pension fund branch organizations have provided comments to the Treasury Department requesting clarification and modification of the rules. The modifications enacted by the 2018 Act address some – but far from all – issues raised with respect to the application of Section 897(l).

Under prior law, a “qualified foreign pension fund” was generally defined as any trust, corporation, or other organization or arrangement:

- (A) which is created or organized under the law of a country other than the United States;
- (B) 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;
- (C) which does not have a single participant or beneficiary with a right to more than five percent of its assets or income;
- (D) 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
- (E) with respect to which, under the laws of the country in which it is established or operates, (i) contributions to such trust, corporation, organization, or arrangement which 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 (ii) taxation of any

investment income of such trust, corporation, organization or arrangement is deferred or such income is taxed at a reduced rate.

The 2018 Act modified the definition of a “qualified foreign pension fund” as follows:

- The “B” prong is revised to expressly state that a qualified foreign pension fund may be established by a foreign country (or political subdivision thereof) or other employer;
- The “B” prong is further modified to state that a foreign pension fund may be established to provide retirement or pension benefits to self-employed individuals;
- The “D” prong is expanded to state that annual information is provided to or is *otherwise available* to local tax authorities (emphasis added); and
- The “E” prong is expanded in (i) to refer not only to “such entity” but to “such entity or arrangement,” and in (ii) to include a reference to income that is excluded from taxation.

The modifications adopted by the 2018 Act are generally retroactively effective as if adopted in 2015. The most important of the modifications are likely the inclusion of self-employed individuals in the “B” prong and the relaxation of the “D” prong relating to the annual information filing requirement.

The modification of the “B” prong to include pension funds established for self-employed individuals could arguably be viewed as being at odds with the other modification of the “B” prong (i.e., the reference to the fund being established by a country or an employer). That is, self-employed individuals typically do not have an “employer” and may in many cases be self-funding their pension funds.

However, based on the statutory language, Congress clearly intended to extend the definition of a “qualified foreign pension fund” to include pension funds established for self-employed individuals. In addition, the reference in the “B” prong to funds established by a “country” or “one or more employers” was intended to clarify that a qualified foreign pension fund may include government-established funds as well as multiemployer plans (as opposed to disqualifying funds for self-employed individuals):

*The [Bill] revises the second prong of the definition to clarify that a government-established fund to provide public retirement or pension benefits may qualify, as well*

*as a fund established by more than one employer to provide retirement or pension benefits to their employees, such as a multiple-employer or multiemployer plan.<sup>1</sup>*

Thus, it seems clear that funds established for self-employed individuals may satisfy the definition of a “qualified foreign pension fund” and, for that purpose, the reference in the “B” prong to an “employer” should be interpreted to refer to the self-employed individual (i.e., as employer of itself).

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<sup>1</sup> JCX-6-18 (March 22, 2018) Technical Explanation Of The Revenue Provisions Of The House Amendment To The Senate Amendment To H.R. 1625, p. 33.

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