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SHOULD FOREIGN PENSION FUNDS WITH U.S. INVESTMENTS PAY U.S. TAX?

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ABSTRACT

U.S. and foreign pension funds are investing heavily outside of their home countries. With the aging of the world's population, this trend will likely intensify. Most countries, including the U.S., accord a tax exemption to certain qualified pension funds organized within their own country; however, when a foreign pension fund invests in the U.S., the U.S. tax code does not recognize its tax exemption. Responding to the need to attract greater investment in U.S. infrastructure, Congress in 2015 enacted a new provision ameliorating the tax treatment of foreign pension plans investing in U.S. real estate. This Article examines whether the U.S. should recognize a foreign pension plan's home country exemption so as to avoid claims of unequal treatment and disincentives to investment in the U.S. This Article concludes that these concerns are best dealt with through reciprocal provisions in tax treaties, and that the provisions of the 2015 legislation are not properly tailored toward achieving their stated goal.

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INTRODUCTION

U.S. and foreign pension funds are investing significant amounts outside of their home countries.[1] Recently, the potential for foreign pensions to provide funding for improvements in U.S. infrastructure motivated President Obama to propose, and Congress to enact, legislation to ameliorate the U.S. income tax treatment of foreign pension funds. This Article will explore the U.S. income tax treatment of foreign pension funds, as determined by the Internal Revenue Code and treaties, and consider the appropriateness of these U.S. tax rules.

The Internal Revenue Code (I.R.C. or Code) provides that U.S. pension funds meeting certain "qualification" standards are generally exempt from U.S. tax with respect to their income. This exemption is one component of a broader U.S. retirement tax scheme designed to encourage the accumulation of savings to be drawn on by workers when they retire. Wages that are saved and invested outside of qualified retirement schemes are taxed currently to the workers, as is the income earned on these investments. By contrast, wages contributed by an employee (or his employer) to a qualified retirement plan are not currently taxed, and the income earned in the plan is also exempt. Withdrawals from these plans by the employee are taxed in full. The overall effect is that the employee is taxed only when savings are withdrawn for consumption, as in a consumption tax.[2]

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[1] *See, e.g.*, NICHOLAS TAN, WILLIS TOWERS WATSON, GLOBAL PENSION ASSET STUDY 2016 EXECUTIVE SUMMARY (2016), http://www.slideshare.net/TowersWatson/global-pension-assets-study-2016?from_action=save [http://perma.cc/VEE8-K6LY]; PRICEWATERHOUSE COOPERS, BEYOND THEIR BORDERS, EVOLUTION OF FOREIGN INVESTMENT BY PENSION FUNDS 4, 7–8 (2015), http://www.alfi.lu/sites/alfi.lu/files/files/Publications_Statements/Surveys/Beyond-their-borders-Evolution-of-foreign-investment-by-pension-funds-final.pdf [http://perma.cc/4G78-RASM]; *see also* ORG. ECON. CO-OPERATION DEV., POOLING OF INSTITUTIONAL INVESTORS CAPITAL—SELECTED CASE STUDIES IN UNLISTED EQUITY INFRASTRUCTURE 9–10, 16, 20, 34, 53 (Apr. 2014), https://www.oecd.org/finance/OECD-Pooling-Institutional-Investors-Capital-Unlisted-Equity-Infrastructure.pdf [https://perma.cc/UZ3M-3AD6].

[2] *See* Cynthia Blum, *Migrants with Retirement Plans: The Challenge of Harmonizing Tax Rules*, 17 FLA. TAX REV. 1, 4–5 (2015) [hereinafter *Migrants*].

Many other countries have adopted similar tax incentives for savings in "qualified" retirement plans organized in their own country. However, under the Code, the foreign plan's qualification and exempt status in its home country is not recognized by the U.S. Therefore, the U.S. may impose a current source-based tax on the U.S.-source income earned by the foreign plan. This assumes that the foreign retirement plan does not qualify for exemption for certain income as a foreign sovereign pursuant to section 892 of the Code.[3] This tax may be imposed on the plan (if it is viewed as a separate foreign entity) or may be imposed on the beneficiary (if the plan is not viewed as a separate entity). If a foreign pension plan is tax-exempt in its home country, it will not be able to claim a foreign tax credit there. As a result, U.S. investments by the foreign pension plan incur a tax burden that is avoided by U.S. tax exempt pension plans or by the foreign plan if it invests in its home country.

Part I of this Article will describe in more detail the U.S. tax treatment (both statutory and through treaties) of foreign pension plans receiving U.S.-source dividends or investing in U.S. real estate. Part II examines the rationales offered for the U.S. recognizing the tax exemption of a foreign pension plan, and compares the use of a tax treaty or congressional action for this purpose. This part raises questions about the design of the 2015 legislation that seeks to ameliorate the tax treatment of U.S. real estate investment. The Conclusion states that a reciprocal treaty-based exemption for dividends is appropriate, but that the 2015 legislation alleviating the U.S. tax burden for real estate investments is flawed.

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[3] All section references hereinafter are to the Internal Revenue Code. For fuller analysis of I.R.C. section 892, see Kimberly Blanchard, *Section 892: Form, Function, and Meaning*, TAX NOTES TODAY, May 24, 2016, at 2–3, LEXIS, 2016 TNT 133-9 (pt. 1), July 19, 2016 at 12–13, LEXIS, 2016 TNT 138-8 (pt. 2), June 22, 2016 at 18–19, 21, LEXIS, 2016 TNT 143-8 (pt. 3) [hereinafter *Section 892*]; *see also* Jennifer Bird-Pollan, *The Unjustified Subsidy: Sovereign Wealth Funds and the Foreign Sovereign Tax Exemption*, 17 FORDHAM J. CORP. & FIN. L. 987, 1004–05 (2012); Michael S. Knoll, *Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?*, 82 S. CAL. L. REV. 703, 712 (2009); Victor Fleischer, *A Theory of Taxing Sovereign Wealth,* 84 N.Y.U. L. REV. 440, 459–60, 465–66 (2009). For interaction of section 892 and section 897(l), see Blanchard, *Section 892* (pt. 3), *supra*, at 18–21. *See also infra* note 52 and accompanying text.

I. Current Law and a New Development

A. U.S. Tax Treatment of a Foreign Pension Fund Under the Internal Revenue Code

Under the Internal Revenue Code, certain "trust[s] ... forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries" are "qualified" under section 401(a), and therefore are entitled to an exemption from tax under section 501(a), subject to an exception for unrelated business income.[4] The complex and extensive set of requirements required for qualification include provisions designed to insure that the plan does not discriminate in favor of highly compensated employees, that employees' rights vest within a certain period of time, that distributions are not made prior to an age appropriate for retirement, that the amount of contributions to the plan is limited, that distributions from the fund begin no later than at age seventy-and-a-half (rather than being accumulated for beneficiaries), and that the benefit of the plan does not inure to the trustee or employer.[5] Section 401(a) also requires that the plan be organized in the United States.[6] If these requirements are met, not only is the qualified trust tax-exempt, but contributions to the plan (up to certain limits) are not currently taxable to the employee (despite constituting a form of compensation), and any tax on an employee is further delayed until the time of a distribution to him.[7]

Similarly, the Code grants tax exemption to an "individual retirement account," which is a trust organized in the U.S., receiving only cash contributions which are limited in amount and come from a specific individual.[8] The individual must have a nonforfeitable interest and must begin to receive distributions by age seventy-and-a-half, and would be penalized for premature distributions.[9]

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[4] I.R.C. § 401(a) (2015); *see also id.* § 501(a).

[5] *See id.* § 401(a)(4), (7), (9).

[6] *Id.* § 401(a).

[7] *See generally* Boris I. Bittker & Lawrence Lokken, Fed. Tax'n of Income, Ests. & Gifts, pt. 8, ch. 61, Westlaw (database updated 2017) [hereinafter Federal Taxation].

[8] I.R.C. § 408(a).

[9] I.R.C. § 408(a)–(b).

Similarly to the case of a pension or profit-sharing plan, the individual deducts contributions to the trust, earnings in the trust are not taxed currently to the trust or the individual, and the individual is taxed on distributions received from the trust.[10] However, in the case of an individual who is covered by an employer retirement plan, a deduction for a contribution is allowed only if the individual's income is below a certain ceiling.[11] In addition, no deduction is allowed for an individual's contribution to a Roth IRA, although no further tax is imposed on the IRA's income or on distributions to the individual.[12]

Since a retirement plan organized in a foreign country will not meet the requirements for tax exemption in the U.S. under section 401(a), or section 408,[13] U.S. source income of the plan will not be eligible for exemption or deferral in the U.S., but rather will be treated simply as income earned by a foreign entity. Under U.S. classification rules, the foreign plan may be classified either as a nonqualified employees' trust, a corporation, or as a grantor trust, which is disregarded.[14] U.S. source dividends and non-portfolio interest earned by a foreign employees' trust or foreign corporation would be subject to a 30 percent withholding tax, and any of its income connected with the conduct of a U.S. business by the trust would be taxed at regular U.S. rates; if the entity is a grantor trust, the 30 percent tax or the tax on effectively connected income would be imposed on the foreign grantor.[15]

Contributions to a foreign employees' trust are not deductible in the U.S., and a U.S. resident or citizen may be taxed on the increase in the value of his interest in the trust, if he is a highly compensated individual and the plan does not meet requirements

[10] *See* FEDERAL TAXATION, *supra* note 7, pt. 8, ch. 62, ¶ 62.3.1.

[11] I.R.C. § 219(a), (b), (g).

[12] *Id.* § 408A; *see also* FEDERAL TAXATION, *supra* note 7, pt. 8, ch. 62, ¶ 62.3.1.

[13] Nor will a foreign pension fund qualify as an exempt labor organization within the meaning of section 501(c)(5). *Stichting Pensioenfonds Voor de Gezondheid, Geestelijke en Maatschappelijke Belangen v. United States*, 129 F.3d 195, 198–200 (D.C. Cir. 1997) (explaining that Dutch pension fund jointly controlled by employers and unions argued for U.S. federal tax exemption based on the theory that it should be treated as a labor organization under U.S. law).

[14] *See Migrants*, *supra* note 2, at 11–14.

[15] *See id.* at 13.

for nondiscrimination.[16] A U.S. resident or citizen who owns a foreign individual retirement plan is taxed currently on the plan's investment income if the plan is characterized by the U.S. as a grantor trust.[17] In all of these contexts, the statute does not take into account whether the entity is accorded special treatment under the tax laws of the country where the plan is organized.[18]

B. U.S. Tax Treatment of Investment Income of a Foreign Pension Fund Under Treaties

Treaty provisions can be extremely helpful to pension funds organized in a country that has entered into a treaty with the U.S. Under many U.S. treaties, a foreign pension fund (as defined therein) may be treated as a "resident" of the other Contracting

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[16] *See id.* at 14–15. However, the beneficiary of a foreign pension trust is taxed in the same manner as the beneficiary of an exempt employee trust if under I.R.C. section 402(d) the only non-qualifying aspect of the foreign pension trust is that it is not organized in the U.S. For a discussion of problems created for U.S. citizens working abroad, see Jacqueline Bugnion & Paula N. Singer, *A Proposal for Fair U.S. Tax Treatment of Foreign Pensions*, TAX NOTES TODAY, May 30, 2016, at 1263–65, LEXIS, 2016 TNT 105-7. The authors note that most treaties do not solve these problems for a U.S. citizen working in a treaty country. *Id*.

[17] *Migrants*, *supra* note 2, at 14–15. Under section 402(b)(3), a non-qualified employees' trust will not be treated as a grantor trust. *See* Abraham Leitner, *Canada-US Treaty Election for Non-Resident Alien Beneficiaries of Canadian Pension Plans*, 60 CAN. TAX J. 1017, 1019 n.7 (2012). As noted by Leitner, this could include "a plan established by a self-employed individual ... established with respect to a specific trade or business of the individual that is regarded as the employer with respect to the plan." *Id.* at 1022. However, in the case of a defined contribution plan in which the majority of contributions are made by employees, the employee contributions may be viewed as a grantor trust. *See* Steve K. Yeager & Lawrence J. Chastang, CliftonLarsonAllen LLP, *Foreign Pensions, Retirement Plans and the U.S. Taxpayer*, *in* 2 32ND ANNUAL INT'L TAX CONFERENCE at 14.8–14.9 (2014) (on file with the author). A Canadian registered retirement savings plan, which can be set up by any individual who has "earned income," would be classified as a grantor trust. Leitner, *supra,* at 1022. *See generally* James Cassidy, *Tax Implications of Foreign Pension Plan Participation*, TAX STRINGER (Mar. 1, 2012), http://www.nysscpa.org/news/publications/the-tax-stringer/stringer-article-for-authors/tax-implications-of-foreign-pension-plan-participation#sthash.6pMLK7r2.dpbs [https://perma.cc/6SQ4-DY8U].

[18] *Migrants*, *supra* note 2, at 14 n.40.

State,[19] and could receive a reduced withholding rate with respect to dividends and a reduced rate or exemption for non-portfolio interest. In addition, some U.S. treaties,[20] including those with

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[19] *See, e.g.*, Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Ir.-U.S., July 18, 1997, S. TREATY DOC. NO. 105-31, art. 4, ¶ 1(c) (treating as a resident "a pension trust and any other organization established in that State and maintained exclusively to administer or provide retirement or employee benefits that is established or sponsored by a person that is otherwise a resident under Article 4 (Residence)[.]"). As stated in the technical explanation of the treaty:

> The inclusion of this provision is intended to clarify the generally accepted practice of treating an entity that would be liable for tax as a resident under the internal law of a state but for a specific exemption from tax (either complete or partial) as a resident of that state for purposes of paragraph 1. Thus, a U.S. pension trust, or an exempt section 501(c) organization (such as a U.S. charity) that is generally exempt from tax under U.S. law is considered a resident of the United States for all purposes of the treaty.

U.S. DEP'T OF THE TREASURY, TECHNICAL EXPLANATION OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS 301 (1997), https://www.irs.gov/pub/irs-trty/iretech.pdf [https://perma.cc/R5GQ-DWAE]; *see also* Convention Between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Belg.-U.S., Nov. 27, 2006, S. TREATY DOC. NO. 110-3, art. 4, ¶ 3(a); A Convention Between the United States of America and New Zealand for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, N.Z.-U.S., July 23, 1992, S. TREATY DOC. NO. 97-27, art. 4, ¶ 1 (stating that pension fund established in Contracting State is "resident" of that state and retained in Protocol of December 1, 2008); U.S. DEP'T OF TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF 2016, art. 4, ¶ 2(a) (2016), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf [https://perma.cc/2TMP-VQZR] [hereinafter 2016 U.S. MODEL TAX TREATY]; U.S. DEP'T OF TREASURY, UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, art. 4, ¶ 2 (2006), https://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf [https://perma.cc/DL8N-FMNK] [hereinafter 2006 U.S. MODEL TAX TREATY].

[20] For a discussion of the rules in the EU, see Luc de Broe & Robert Neyt, *Tax Treatment of Cross-Border Pensions Under the OECD Model and EU Law*, BULLETIN FOR INT'L TAX'N, Mar. 2009, at 86, 89–91. *See also* Hans van Meerten & Bastiaan Starink, *Cross-Border Obstacles and Solutions for Pan-European*

Canada,[21] the U.K.,[22] Belgium,[23] and Germany,[24] provide a complete exemption for dividends paid to a foreign pension fund. This

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Pensions, 20 EC TAX REV. 30, 36 (2011) (explaining that no pension scheme meets all the requirements "in more than one country").

[21] *Compare* Protocol Amending the 1980 Tax Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Can.-U.S., Sept. 21, 2007, S. TREATY DOC. NO. 110-15, art. 16, ¶ 2 (treating pension plans as exempt with respect to interest and dividends), *with id*. art. 16, ¶ 1 (treating charitable organizations as exempt to the same extent as in country of residence). *See* Jack M. Mintz & Stephen R. Richardson, *Not Just for Americans: The Case for Expanding Reciprocal Tax Exemptions for Foreign Investments by Pension Funds*, 7 UNIV. CALGARY SCH. PUB. POL. RES. PAPERS 1, 10 (2014). These authors state that this provision in the U.S.-Canada treaty is the only provision in a Canadian tax treaty providing pension fund exemptions for both interest and dividends. *Id.*

[22] Convention between the Government of the United States of America and the Government of the United Kingdom Regarding Double Taxation and Prevention of Fiscal Evasion, U.K.-U.S., July 19, 2002, S. TREATY DOC. NO. 107-19, art. 10, ¶ 3(b). The exemption for dividends paid to pension scheme of Contracting State is also included in the 2001 version of the treaty. Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains, U.K.-U.S., July 24, 2001, art. 10, ¶ 3(b), https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/uktreaty.pdf [https://perma.cc/5KV4-4CBN] (unenacted).

[23] Convention Between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Belg.-U.S., Nov. 27, 2006, S. TREATY DOC. NO. 110-3, art. 10, ¶¶ 3(b)–4(b); *see also* de Broe & Neyt, *supra* note 20, at 90.

[24] Protocol amending Tax Convention with Germany, Ger.-U.S., June 1, 2006, S. TREATY DOC. NO. 109-20, art. 10, ¶ 3(b) (providing dividend exemptions for pension funds) [hereinafter U.S.-Germany Treaty]. *See id.* art. 10, ¶ 11, defining a pension fund as:

> any person that:
>
> a) is established under the laws of a Contracting State;
>
> b) 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 or more of such persons; and
>
> c) is either,
>
> aa) in the case of the United States, exempt from tax in the United States with respect to the activities described in subparagraph b) of this paragraph, or

same approach was followed in the 2006 and 2016 U.S. Model Tax Treaties.[25] For these purposes, the Model Treaty requires that a foreign pension fund be "generally exempt from income taxation" in the country in which it is established.[26]

As noted above, in the case of a foreign individual retirement trust, which the Code treats as a grantor trust, the U.S. source income of the trust would be taxable immediately to the grantor-beneficiary.[27] It is not clear that current treaty provisions would prevent this even when the fund and participant reside in a country with a U.S. tax treaty. The commonly used treaty provision exempting a pension payment from source-country tax may not be considered applicable in this context.[28] And, a newer treaty

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> bb) in the case of the Federal Republic of Germany, a plan the contributions to which are eligible for preferential treatment under the Income Tax Act.

[25] 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 10, ¶ 3; *see also* 2006 U.S. MODEL TAX TREATY, *supra* note 19, art. 10, ¶ 3; ORG. ECON. CO-OPERATION DEV., MODEL TAX CONVENTION ON INCOME AND ON CAPITAL C(18)-23 (June 15, 2014), http://www.oecd.org/tax/treaties/model-tax-convention-on-income-and-on-capital-2015-full-version-9789264239081-en.htm [https://perma.cc/F5UP-8AEA] [hereinafter OECD MODEL TAX CONVENTION] (stating that "[w]here, under their domestic law, two States follow the same approach of generally exempting from tax the investment income of pension funds established in their territory, these States, in order to achieve greater neutrality with respect to the location of capital, may want to extend that exemption to the investment income that a pension fund established in one State derives from the other State"). *See* Tax Convention with Chile, Chile-U.S., Feb. 4, 2010, S. TREATY DOC. NO. 112-8, art. 10, ¶ 3 (at the time of this Article's publishing, the Tax Convention with Chile remained pending), stating:

> dividends may not be taxed in the Contracting State of which the payer is a resident if the beneficial owner of the dividends is an entity that is established and maintained in the other Contracting State principally to provide or administer pensions or other similar benefits to employed and self employed persons, or to earn income for the benefit of one or more such arrangements, and that is generally exempt from tax in that other State, provided that such dividends are not derived from the carrying on of a trade or business by the beneficial owner or through an associated enterprise.

[26] *See* 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 3 ¶ 1(k).

[27] *See Migrants*, *supra* note 2, at 14.

[28] Article 17, paragraph 1(a) of the 2016 U.S. Model Tax Treaty provides that "[p]ensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that Contracting State." 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 17, ¶ 1(a). But it is unclear

provision, contained in the 2016 U.S. Model Treaty, providing for deferred taxation of income earned in a pension fund to a participant, appears to be applicable only when the participant is not a resident in the Contracting State in which the pension fund is established.[29]

C. Foreign Pension Funds and FIRPTA

The treatment of foreign pension funds investing in U.S. real property (directly or indirectly) has been much discussed and recently was made more generous by the PATH Act.[30] As a foreign

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whether the U.S. investment income earned (but not distributed) by a foreign individual retirement account of a foreign individual is treated as a pension for this purpose. If it is treated as a pension, then the U.S. would not be permitted to tax. But if the accruing income is not treated as a pension, then perhaps the treaty provisions of Articles 10, 11 and 12 would apply as if the beneficiary is earning investment income directly. Similar rules might be applicable to the portion of an employee trust attributable to employee contributions. *See supra* note 17.

[29] *See* 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 17, ¶ 2(a), stating that:

> [w]here an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension fund established in the other Contracting State, income earned by the pension fund may not be taxed as income of that individual unless, and then only to the extent that, it is paid to, or for the benefit of, that individual from the pension fund ....

See also Tax Convention with Chile, *supra* note 25, art. 18, ¶ 4.

[30] The PATH Act refers to Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, 129 Stat. 2242, 3040 (2015). For articles prior to the enactment of PATH, see, for example, Benedict Kwon, *Tax Structuring for Foreign Pension Fund Investments in U.S. Real Estate Funds*, 15 J. PRIV. EQUITY 79, 81–82 (2011) (discussing private REIT and leveraged blocker structures for real estate investments by foreign pension funds); Marc Heller, *FIRPTA Exemption for Foreign Pension Funds Foiled, for Now, by Cost*, DAILY TAX REP., Feb. 18, 2015, BLOOMBERG BNA, 33 DTR G-3; Marc Heller, *FIRPTA Repeal Can Wait, Lawmaker Says, While Idea of Limiting the Tax Gains Steam,* DAILY TAX REP., May 1, 2015, BLOOMBERG BNA, 85 DTR G-2; Ameek Ashok Ponda, *Foreign Pension Plans Investing in Shares of a U.S. REIT*, TAX NOTES TODAY, Mar. 24, 1997, LEXIS, 97 TNT 56-55, § I.B(1)(9); James D. Reardon & Elizabeth B. Behncke, *Foreign Pensions Could Back US Infrastructure*, LAW360 (Apr. 16, 2013, 6:36 PM) https://www.law360.com/projectfinance/articles/433418/foreign-pension-funds-could-back-us-infrastructure [https://perma.cc/4K6P-WYAZ]; Willard B. Taylor, *Is the Real Estate Investment and Jobs Act a Good Idea?*, 148 TAX NOTES 993, 993–94 (2015), https://www.sullcrom.com/files/upload/REIT_Legislation_Article.PDF [https://perma.cc/7Y2X-FV54] [hereinafter Taylor, *Real Estate*]; Letter from Gregory Berger, Brownstein Hyatt Farber Schreck, LLP et al. to Mark J.

entity, a foreign pension fund may be taxed at regular U.S. rates by the U.S. on any income that is effectively connected with a U.S. trade or business.[31] Under section 897(a) of the Code (FIRPTA), gain derived from the disposition of a U.S. real property interest (USRPI) is treated as effectively connected with a U.S. trade or business.[32] In many cases, an interest in an infrastructure asset will fall within the definition of a U.S. real property interest.[33] A U.S. real property interest will also include ownership of shares

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Mazur, Assistant Secretary for Tax Policy, Requested Modification to Notice 2007-55 with respect to Foreign Pension Funds (Oct. 8, 2013) (on file with the U.S. Department of the Treasury), http://www.rer.org/10-08-13-FIRPTA-attorneys-to-Mazur.aspx [https://perma.cc/JQ9V-LJJN]. For articles after the enactment of PATH, see, for example, Kimberly S. Blanchard, *New §897(l) Exempts Qualified Foreign Pension Plans from FIRPTA*, 45 TAX MGMT. INT'L J. 163 (Mar. 11, 2016) [hereinafter *FIRPTA*]; Peter A. Glicklich et al., *Will Canadian Pension Funds Feast on U.S. Infrastructure (Without FIRPTA)?*, 45 TAX MGMT. INT'L. J. 217 (Apr. 8, 2016) [hereinafter *Canadian Pension Plans*]; Lynn T. Kawaminami & Jeffrey M. Rubin, *The REIT PATH Forward—Mostly a Smooth Ride but Watch Out for the Potholes*, 57 TAX MGMT. MEMORANDUM (July 25, 2016), BLOOMBERG BNA; Scott L. Semer, *FIELDS and DREAMS—Potential U.S. Real Estate Investment Opportunities Created by §897(l)*, 32 TAX MGMT. REAL EST. J. 131 (2016), BLOOMBERG BNA [hereinafter *Fields and Dreams*]; Randyl Drummer, *How Big a Factor Will New FIRPTA Rules Be in Attracting More Foreign Investment in U.S. Real Estate?*, COSTAR (Jan. 13, 2016), http://www.costar.com/News/Article/How-Big-a-Factor-Will-New-FIRPTA-Rules-Be-in-Attracting-More-Foreign-Investment-in-US-Real-Estate-/178783 [https://perma.cc/86MZ-BWF6].

[31] I.R.C. §§ 871(b), 882(a).

[32] Section 897 and related provisions are often referred to as "FIRPTA," an abbreviation for the Foreign in Real Property Tax Act of 1980, Pub. No. L. 96-499, 94 Stat. 2682 (1980), which adopted section 897 of the Code. *See* Willard B. Taylor, *Suppose FIRPTA Was Repealed*, 14 FLA. TAX REV. 1, 16 (2013) (referring to a 1979 U.S. Treasury study, for the conclusion that "taxing foreign investors on gain from the disposition of directly-held real property was consistent with international standards (and, indeed, that the pre-FIRPTA exemption for non-effectively connected gain from the disposition of real property was 'unusual by international standards')") [hereinafter *FIRPTA Repeal*]. *See* U.S. DEP'T OF THE TREASURY, TAXATION OF FOREIGN INVESTMENT IN U.S. REAL ESTATE, at 52–53 (1979).

[33] *FIRPTA*, *supra* note 30, at 1 n.2 (explaining "[a]lthough the contours of the definition remain unclear, most infrastructure assets likely qualify as USRPIs"). Under section 897(c)(6)(B) of the Code, real property includes "movable walls, furnishings, and other personal property associated with the use of the real property." *See also* Treas. Reg. § 1.897-1(b)(4)(i) (interpreting these terms).

in a U.S. corporation that is a U.S. real property holding company.[34] U.S. treaties do not provide an exemption from tax for capital gains on the disposition of a real property interest.[35] Thus, before the PATH Act, a foreign pension fund could generally be expected to be taxed on gains derived from the sale of U.S. real estate or stock of a U.S. real property holding company; the same would be true for gain derived from sale of a partnership interest to the extent attributable to a U.S. real property interest.[36] The Code provided an exception for publicly traded stock if the taxpayer's interest did not exceed 5 percent.[37] A common technique to avoid FIRPTA taxation for a direct investment in U.S. real estate is to utilize a leveraged blocker corporation.[38]

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[34] I.R.C. § 897(c)(1)(A)(ii); *see* Wei Cui, *Taxing Indirect Transfers: Improving An Instrument for Stemming Tax and Legal Base Erosion*, 33 VA. TAX REV. 653, 654–55 (2014) [hereinafter *Indirect Transfers*] (noting as a new development "the adoption by several major non-OECD countries, including India, China, Indonesia, and Peru, among others, of a policy of taxing foreigners on the sale of interests in foreign entities that hold assets indirectly in these countries"). Taylor notes that the OECD Model "was revised in 2003" to allow taxation of real estate holding companies. *FIRPTA Repeal*, *supra* note 32, at 17 n.65; OECD MODEL TAX CONVENTION, *supra* note 25, art. 13, § 4, at M-37. *See also* U.N. Dep't of Economic & Social Affairs, United Nations Model Double Taxation Convention between Developed and Developing Countries, art. 13, ¶ 4(b) (2011), http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf [https://perma.cc/R6BQ-UPEK]; Cui, *supra*, at 660 n.16 (noting this type of tax is allowed in the UN Model as well).

[35] *See* 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 13, ¶ 1–2; *FIRPTA Repeal*, *supra* note 32, at 38. Treaties adopted before 1980 were overridden by FIRPTA, but with an extended effective date. *See FIRPTA Repeal*, *supra* note 32, at 16–17.

[36] *See* I.R.C. § 897(g). For a further discussion, see *FIRPTA Repeal*, *supra* note 32, at 20. However, in the case of an interest in a publicly traded partnership, meeting the income test of I.R.C. § 7704(c), the 5 percent exception for publicly traded corporate stock is permitted. *FIRPTA Repeal*, *supra* note 32, at 21.

[37] I.R.C. § 897(c)(3).

[38] *See, e.g.*, *Canadian Pension Plans*, *supra* note 30 (explaining that, after PATH, "tax structuring to avoid ECI, such as through leveraged blockers or compliance with §892, remain as critical as ever for reducing U.S. income tax on foreign pension funds' investments in U.S. infrastructure"); Kwon, *supra* note 30, at 81 (discussing leveraged blockers). For concerns about proposed Treasury Regulations under I.R.C. section 385, see Guthrie Stewart, *Canadian Pension Fund Addresses Impact of Debt-Equity Regs. (Section 385—Interest as*

Another vehicle for ownership of U.S. real property by a foreign pension fund is by owning stock in a real estate investment trust (REIT); a REIT generally avoids entity-level tax because it is allowed a deduction for dividends distributed.[39] Under section 897(h), a distribution by a qualified investment entity, including a REIT, to a foreign taxpayer is treated as the disposition of a U.S. real property interest by the taxpayer to the extent attributable to the entity's disposition of a U.S. real property interest.[40] Prior to PATH, this rule was not applicable to a foreign person holding "less than 5%" of publicly traded stock of the REIT.[41] In addition, stock in a domestically controlled REIT is not treated as a U.S. real property interest, so disposition of such stock will not trigger the application of section 897.[42] The term "domestically controlled" means that less than 50 percent is held directly or indirectly by a foreign person.[43] Thus, the specter of section 897 was present if a foreign pension fund invested in a REIT that was not

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Stock or Indebtedness), TAX NOTES TODAY, July 6, 2016 at 4, LEXIS, 2016 TNT 129-22. Final regulations under section 385 were adopted in October 2016. The preamble states: "The final and temporary regulations do not adopt special rules for debt instruments issued by investment partnerships, including indebtedness issued by certain 'blocker' entities. The Treasury Department and the IRS continue to study these structures and these transactions in the context of the section 385 regulations." Treatment of Certain Interests in Corporations as Stock or Indebtedness, 81 Fed. Reg. 72,858, 72,868 (Oct. 21, 2016) (to be codified at 20 C.F.R. pt. 1).

[39] For definition of a REIT, see I.R.C. section 856. For tax treatment of a REIT and its beneficiaries, see I.R.C. section 857. *See generally*, Richard M. Nugent, *REIT Spinoffs: Passive REITs, Active Businesses*, TAX NOTES, March 23, 2015, at 1517–29 (discussing requirements for qualification as a REIT).

[40] I.R.C. § 897(h)(1).

[41] *Id.*

[42] *Id.* § 897(h)(2).

[43] I.R.C. § 897(h)(2), (4)(B). For discussion, see, for example, John Grumbacher et al., *A Primer on Using Private Domestically Controlled REITs for International Investors in U.S. Real Estate,* TAX MGMT. REAL EST. J. 355, 355 (2013), BLOOMBERG BNA. For criticism of the rule, see *FIRPTA Repeal*, *supra* note 32, at 31, calling the "domestically-controlled" exception "bizarre." Taylor explains that if the rationale was to "quash 'planning techniques' of foreign investors" then this exception should, to be consistent, also be extended to "other USRPHCs or to partnerships." *FIRPTA Repeal, supra* note 32, at 31; s*ee also* Donald E. Rocap & Russell S. Light, *The Mixed Up World of Pseudo Passthroughs*, 85 TAXES MAG. 323, 337 (Mar. 2007) (arguing that the exception for sale of stock of domestically controlled REIT is "questionable").

publicly traded and not domestically controlled. In addition, section 897 would apply to an interest in a publicly traded REIT where the pension fund's ownership exceeded 5 percent. However, recently, U.S. treaties have provided for a 0 percent rate for dividends paid by a REIT to a foreign pension fund with no more than 10 percent ownership.[44] Under the PATH Act of 2015, the 5 percent limit in the exclusion for publicly traded stock from USRPI status was increased to 10 percent in the case of stock in a REIT.[45] In addition, the 5 percent limit for publicly traded stock in section 897(h)(1) to avoid the look-thru rule for REIT distributions was increased to 10 percent.[46]

More importantly for foreign pension funds, under section 897(l)(1), section 897 does not apply to a USRPI held directly (or indirectly through a partnership) by a qualified foreign pension fund or to any distributions received by a qualified pension fund from a REIT.[47] A qualified foreign pension fund is defined in section 897(l)(2) as a trust, corporation, or other organization or arrangement which is created under foreign law and established to provide retirement benefits to participants or their beneficiaries who are current or former employees in consideration for services rendered. Further requirements for the foreign pension fund are that it is subject to government regulation and provides annual information reports to its local tax authorities. It is also required that the foreign pension fund either receive deductible (or excludible) contributions under the foreign law or that taxation of the

[44] *See* 2016 U.S. MODEL TAX TREATY, *supra* note 19, art. 10, ¶ 4(a)(i); *see also* Tax Convention with Hungary, Hung.-U.S., Feb. 4, 2010, S. TREATY DOC. NO. 111-7, art. 10, ¶ 4(a)(i) (at the time of this Article's publishing, the Tax Convention with Hungary remained unapproved by the U.S. Senate, though signed in 2010); *FIRPTA Repeal*, *supra* note 32, at 38. However, treaties do not bar FIRPTA taxation on disposition of stock in a REIT by a foreign pension plan. *See* Ponda, *supra* note 30, at 1601 n.10.

[45] Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, 129 Stat. 2244, 3040 (2015) (adding new subsection 897(k) to Code).

[46] I.R.C. § 897(k)(1)(A), (B). Further exceptions from FIRPTA are made for "qualified shareholders" of a REIT. A qualified shareholder includes certain qualified collective investment vehicles, including investment vehicles eligible for reduced rates on dividends pursuant to a treaty. *See* I.R.C. § 897(k)(2)(A), (3).

[47] I.R.C. § 897(l)(1). The PATH Act added a new subsection (l) to section 897 of the Code. Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, 129 Stat. 2242, 3040 (2015).

pension fund's investment income is deferred or is taxed at a reduced rate.[48] Finally, no single participant can have a right to more than 5 percent of the pension fund's assets or income.[49]

Under 897(l)(3), the Treasury is authorized to provide regulations that are necessary or appropriate.[50] The staff of the Joint Committee suggests that a broad range of arrangements is intended to be covered by the statute.[51] In addition, commentators and advocates have requested that regulations offer flexibility and clarity.[52]

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[48] *Id.* § 897(l)(2).

[49] *Id.*

[50] *Id.* § 897(l)(3).

[51] STAFF OF THE JOINT COMM. ON TAX'N, 114TH CONG., GENERAL EXPLANATION OF THE TAX LEGISLATION ENACTED IN 2015 at 283 (Comm. Print 2016). The Staff notes that "[f]oreign pension funds may be structured in a variety of ways, and may comprise one or more separate entities" and that the statutory term "'arrangement' encompasses such alternative structures." *Id.* at 283 n.967. It also states the exemption may apply to "[m]ulti-employer and government-sponsored public pension funds" and pension funds "established for one or more companies or professions, or for the general working public of a foreign country." *Id.* at n.968.

[52] For suggestions made to the IRS by various foreign pension groups, see Letter from Kristina Fanjoy, Managing Director, Head of Tax, Canada Pension Plan Investment Board to Internal Revenue Serv. (May 20, 2016), *in* Kristina Fanjoy, *Canadian Fund Weighs in on Foreign Pension Fund Regs. (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, July 27, 2016, LEXIS, 2016 TNT 144-17; Letter from David Taylor, General Counsel, U.K. Pension Protection Fund to Internal Revenue Serv. (July 7, 2016), *in* David Taylor, *U.K. Fund Seeks Treatment as Qualified Foreign Pension Fund (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, July 27, 2016, LEXIS, 2016 TNT 144-18; Letter from Steve Bosse, Vice-President, Tax, Caisse de depot et placement du Quebec & Sylvain Dubois, Vice-President, Tax, Ivanhoe Cambridge Inc. to Mark J. Mazur, Ass't Sec. of the Treasury for Tax Policy, et al. (July 15, 2016), *in* Steve Bosse & Sylvain Dubois, *Quebec Funds Manager Seeks Clarity in PATH Act Changes (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, July 27, 2016, LEXIS, 2016 TNT 144-16; Letter from Fiona Galbraith, Director Policy, the Association of Superannuation Funds of Australia to Mark J. Mazur, Ass't Sec. of the Treasury for Tax Policy & John A. Koskinen, Comm'r, Internal Revenue Serv. (July 21, 2016), *in* Fiona Galbraith, *Australian Nonprofit Seeks Foreign Pension Fund Guidance (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, July 22, 2016, LEXIS, 2016 TNT 141-17; Letter from Klas S.D. Holm, Curtis, Mallet-Prevost, Colt & Mosle LLP to Jason Yen, Dep't of the Treasury (July 25, 2016), *in* Klas S.D. Holm, *Firm Seeks Clarity, Predictability in Foreign Pension Fund Regs. (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, Aug. 10, 2016, LEXIS, 2016 TNT 154-19; Letter

D. FATCA

Foreign pension plans must also be concerned with the application of the Foreign Account Tax Compliance Act (FATCA) rules.[53] While a foreign financial account would generally be subject to FATCA, an exception is made for certain retirement accounts that are tax-favored and for which annual information reporting to the relevant tax authorities is required;[54] there is also an exemption for certain retirement plans, which are divided into the categories of treaty-qualified retirement funds, broad participation retirement funds, and narrow participation funds.[55] In addition, an exemption applies to plans specified in an Intergovernmental Agreement (IGA).[56]

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of Jeffrey D. DeBoer, President and CEO, The Real Estate Roundtable, to Mark J. Mazur, Ass't Sec'y of the Treasury for Tax Policy & William J. Wilkins, Chief Counsel, Internal Revenue Serv., *in* Jeffrey D. DeBoer, *Real Estate Roundtable Seeks Guidance on Foreign Pension Funds (Section 897—Foreigners' Real Estate Sales)*, TAX NOTES TODAY, Aug. 24, 2016, LEXIS, 2016 TNT 164-13. For analysis by commentators, see, for example, *Canadian Pension Plans*, *supra* note 30, at 220–21, noting that the exemption for foreign governments under Section 892 has not been revised similarly, and suggesting that such governmental plans would not be "qualified" under section 897(l). *See also Fields and Dreams*, *supra* note 30, at 132 (noting that it is unclear if a plan "that benefits the 'general working public' ... [or] a plan sponsored by a professional organization or union" would be qualified); *FIRPTA*, *supra* note 30, at 164–65 (noting the existence of ambiguity regarding foreign governmental arrangement that also qualifies under Section 892). Blanchard notes that "the §892 exemption applies only to sales of stock of less-than-50% owned USRPHCs[.]" *FIRPTA*, *supra* note 30, at 165; *see also Section 892* (pt. 3), *supra* note 3, at 21.

[53] Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, tit. V, pt. 1, 124 Stat. 71, 97 (Mar. 18, 2010) (adding sections 1471–74 to the Code); *see generally* David W. Powell, *Non-US Pension Fund Exemptions under the Final FATCA Regulations*, BENEFITS BRIEF (Mar. 5, 2013), http://www.groom.com/media/publication/1225_Non_US_Pension_Fund_Exemptions_Under_Final_FATCA_Regulations.pdf [https://perma.cc/3AFT-ZNTE].

[54] *See Migrants*, *supra* note 2, at 16 n.46 (discussing Treas. Reg. § 1.1471-5(b)(2)(i)(A)); Powell, *supra* note 53 (exemption from "financial account" definition for certain retirement accounts that are tax-favored and for which annual information reporting to the relevant tax authorities is required).

[55] *See Migrants*, *supra* 2, at 16 n.46.

[56] *See* Powell, *supra* note 53, at 5 (noting that "plans listed in Annex II to [an] IGA will be treated as exempt from FATCA without regard to whether the account or fund satisfies the exemptions of the final regulations").

II. ANALYSIS

A. Dividends and Interest

As explained in the previous section, the Internal Revenue Code does not consider a foreign pension trust to be tax-exempt with respect to U.S. source investment income, such as dividends or nonportfolio interest. However, in some treaties, foreign pension trusts are accorded favorable treaty rates, or even complete exemption.[57] This section of the Article will consider whether the current tax treatment is appropriate.

1. Equal Treatment

Some might argue that the U.S. should not tax U.S. source investment income, such as dividends and interest, of a foreign pension trust because this approach denies equal tax treatment of a foreign pension trust and a U.S. qualified pension trust.[58] This argument assumes in effect that foreign trusts that are tax-exempt in their own countries should be viewed as similarly situated with U.S. qualified pension trusts. In other words, the complex and detailed requirements of section 401(a) should be waived for foreign pension trusts provided that the trust meets the foreign country's requirements for tax exemption.

However, this argument overlooks two considerations. First, the requirements for qualification of a pension trust under foreign law may be much less strict than requirements under U.S. law,

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[57] *See* Ponda, *supra* note 30, at 1598, 1601 n.10.

[58] *But see FIRPTA Repeal*, *supra* note 32, at 29–30. Taylor notes that one of the original justifications for the treatment of stock in a U.S. real property holding company as a U.S. real property interest was "to achieve 'horizontal equity' between U.S. and foreign business investment in real estate," but he views this justification as "misguided" in part because "that is not the standard by which taxation of foreign investment is tested." He notes that "[h]orizontal equity would, for example, imply the repeal of the portfolio interest exemption (since no such exemption applies to interest received by a domestic lender), reducing the withholding tax on dividends paid to nonresident aliens to 15 percent (since that is the rate that applies to U.S. residents and citizens) and so on." *Id.* at 30–31. For further discussion of horizontal equity in this context, see Fred B. Brown, *Wither FIRPTA?*, 57 TAX LAW. 295, 301 (2004) [hereinafter *Wither FIRPTA*].

and, thus, may reflect sharply differing social policies.[59] For example, in some countries, a foreign pension trust may be qualified without regard to whether it discriminates against rank and file employees. Second, even if the social policies are the same, the U.S. does not have an obligation to provide savings incentives that are focused on encouraging savings for residents of a foreign country.[60]

In this light, it does not seem unfair for the U.S. to treat a foreign pension fund as it would treat a U.S. nonqualified pension fund. If the trust or its beneficiaries have no other connection to the

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[59] *See* Taylor, *Real Estate*, *supra* note 30, at 998 (noting that the definition of a foreign pension plan in legislation proposed in 2015 "falls … far short of what is required to be a pension plan under the Internal Revenue Code"); *id.* at 996 (noting that "'qualified' foreign pension funds, as defined by the [proposed] legislation, are hardly comparable to U.S. pension funds"); *see also* THUN FIN. ADVISORS RESEARCH, THE FOREIGN PENSION PLAN DILEMMA FOR AMERICAN EXPATS 2 (2016), https://thunfinancial.com/site/wp-content/uploads/2016/03/The-Foreign-Pension-Plan-Dilemma-for-American-Expats2.pdf [https://perma.cc/QT3J-4RE2].

[60] *See* I.R.S. Tech. Adv. Mem. 80-30-005 (Jan. 1, 1980), concluding that a foreign pension fund, that meets all the requirements of section 501(a) except formation in the U.S., cannot benefit from a treaty article providing for nondiscrimination for a permanent establishment of a treaty country corporation. The I.R.S. memo quotes a commentary to Article 24, section 1 of the OECD Model Tax Convention, which explains that nondiscrimination relief is applied to persons "in substantially similar circumstances both in law and in fact." *Id.*; *see also* OECD MODEL TAX CONVENTION, *supra* note 25. However, the letter ruling also notes that under the commentary "the nondiscrimination provisions are not to be construed as obliging a State which accords special taxation privileges to private institutions not for profit whose activities are performed for purposes of public benefit, which are specific to that State, to extend the same privileges to similar institutions whose activities are not for its benefit." I.R.S. Tech. Adv. Mem. 80-30-005. It explains that the exemption for U.S. pension funds is designed "to encourage the development and use of private pension funds by United States employers so that their employees would not have to rely on public welfare after retirement for their support in their old age." *Id.* It concludes that because the pensions paid by the foreign pension funds "are payable primarily to employees other than U.S. nationals or residents ... the social purposes served by domestic pension plans, to benefit American workers, would not apply to a foreign pension fund benefitting primarily foreign workers." *Id.*; *see also* Rev. Rul. 83-144, 1983-2 C.B. 295. (A Philippine pension trust investing in stock in the U.S. cannot rely on a treaty provision requiring nondiscriminatory treatment of a business conducted through a permanent establishment; the IRS also notes that "[t]his Revenue Ruling does not necessarily state the only reason that Article 24 of the Convention is not applicable to these facts.").

U.S., the trust is free to avoid U.S. tax by investing elsewhere. Moreover, the foreign country in which the trust is organized may well deny a tax exemption for income earned by U.S. qualified pension trusts investing in that country. Unless the foreign country is willing to provide a reciprocal exemption for U.S. qualified trusts, it would not be in a position to argue that the U.S. acts unfairly.

A similar approach is adopted in the Internal Revenue Code with respect to income earned by foreign charities. Whatever their classification under foreign law, exemption for their U.S. source income depends on their satisfying the same standards as a U.S. charity (in other words, it is formed for one of the charitable purposes referred to in section 501(c)(3), no part of its earnings inures to the benefit of a private individual, and it avoids excessive lobbying or participation in a political campaign).[61] An exemption under foreign law does not substitute for section 501(c)(3) compliance.[62] If the section 501(c)(3) requirements are met, the foreign charity is exempt from withholding and is potentially subject to the Unrelated Business Tax.[63]

2. Removing Barriers to Investment

At the same time, the U.S. must recognize that its failure to respect the home country's tax exemption for a foreign pension trust makes the U.S. a less desirable location for investment by such trusts than it could be otherwise. When U.S. investment income is earned by a foreign entity that is taxable in its home country, the U.S. tax imposed on such income may be creditable against the home country tax, so that a waiver of U.S. tax may simply shift tax revenue to the home country; but, if the foreign entity is

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[61] I.R.C. § 501(c)(3) (2015). Unlike section 401(a), however, section 501(c)(3) does not require formation in the U.S. On the other hand, formation in the U.S. is required for a charity to qualify to receive deductible contributions. I.R.C. § 170(c)(2).

[62] Pursuant to Treas. Reg. 1.1441-9(b)(2), a withholding agent making a payment to a foreign charity can rely on a Form W-8EXP, with an attached opinion of U.S. counsel that the section 501(c)(3) requirements are met. Steven D. Bortnick & Lisa B. Petkun, *Foreign Tax-Exempt Organizations Exempt From Withholding Tax* (July 2, 2014), http://www.pepperlaw.com/publications/foreign-tax-exempt-organizations-exempt-from-withholding-tax-2014-07-02 [https://perma.cc/767Z-9MGC].

[63] *Id.*

a tax-exempt pension trust, it will not be able to claim a credit for U.S. tax in its home country.[64] In evaluating opportunities for investment in the U.S., the foreign pension trust would need to compare the after-U.S. tax rate of return on U.S. investments with the pre-tax rate of return for local investments.[65] At the same time, if other countries also impose a source-based tax on investment income of foreign pension trusts, any investment outside the pension trust's home country may have to be evaluated on an after-tax basis.[66] Thus, the tax imposed by the U.S. on the trust's investment income may represent an additional burden only in comparison with income earned by the trust in the home country.[67]

In any event, the U.S. may determine that it is in its best interest to make itself more attractive as a location for investment by foreign pension trusts, even if that means foregoing tax revenues; since foreign pensions currently do make U.S. investments notwithstanding the unfavorable tax rules, the tax revenue that would be collected under the current rules would be foregone if the U.S. granted an exemption. And the U.S. may view foreign pension trusts as a relatively reliable, stable source of investment capital.

However, if the U.S. adopted an exemption for foreign pension funds unilaterally, it would need to make an examination of foreign pensions from a large variety of countries to determine whether they are exempt in their home country and conform to some definition of a foreign pension fund that shows sufficient similarity to a U.S. qualified fund.[68] More importantly, if the U.S. takes this step unilaterally, the U.S. is giving up its leverage to achieve reciprocal benefits for U.S. pension trusts investing abroad. This may explain the U.S. approach of denying a statutory exemption for a foreign pension trust, but agreeing to reciprocal exemptions in a treaty.[69]

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[64] Paul Schott Stevens, *Selected Issues in International Taxation of Retirement Savings*, 3 INV. CO. INST. PERSP., Aug. 1997, at 1, 6 [hereinafter *Retirement Savings*] (prepared by Stephen E. Shay).

[65] *See id.*

[66] *See id.* at 7.

[67] *See* Knoll, *supra* note 3, at 704. Knoll notes that [m]ost investors are likely to come from countries with relatively small home markets. Thus, such investors will hold only a small share of their wealth at home if they are trying to minimize portfolio risk. For such investors, therefore, most of their investments outside the United States will also be foreign. *Id.* at 732 n.145.

[68] *Retirement Savings, supra* note 64, at 8.

[69] Countries generally do not act unilaterally to waive source country tax for foreign pension funds. *See id.* at 8.

Reciprocal exemption for pension trusts through a treaty benefits the U.S. not only by encouraging investment in the U.S. but also by providing enhanced investment opportunities for U.S. pension trusts wishing to achieve greater diversification. In this way, the reciprocal exemption promotes the U.S. goal of encouraging retirement savings by its own residents (although the exemption granted to U.S. pension trusts by a treaty partner does not produce new tax revenue for the U.S. offsetting its revenue loss with respect to investments by foreign pension trusts).[70] In the context of a reciprocal provision in a treaty, an exemption has been advocated by some commentators as a way to increase the efficiency of global investments.[71] And, as noted, the treaty provides a useful vehicle for each country to identify its pension trusts fitting within this category.[72]

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[70] *Id.*

[71] *See id.* at 6; Mintz & Richardson, *supra* note 21, at 10 (arguing that Canada should provide the same reciprocal treaty exemption now found only in its U.S. treaty to other treaty partners); Jack Mintz & Stephen Richardson, *Attracting foreign infrastructure capital with cross-border tax incentives*, FIN. POST: FP COMMENT (Nov. 5, 2014), http://business.financialpost.com/fp-comment/attracting-foreign-infrastructure-capital-with-cross-border-tax-incentives [https://perma.cc/SL97-TU6C]; *see also* Letter of David W. Powell, Groom Law Group, to John Harrington, International Tax Counsel, Dep't of the Treasury et al., Comments on Certain Pension Aspects of the United States Model Tax Treaty (July 13, 2009), http://www.groom.com/media/publication/502_model%20treaty%20comments%20071009.pdf [https://perma.cc/M7DN-B7EW] (referencing commentary contained in OECD MODEL TAX CONVENTION, *supra* note 25) (arguing that "[s]uch a provision would both facilitate the free flow of investment capital and benefit plan participants and beneficiaries by allowing plans to diversify by appropriate international investment at a lower cost.").

[72] *See* 2016 U.S. MODEL TAX TREATY, *supra* note 19, at 70 (suggesting use of an appended protocol to identify each country's qualified pension funds). In the sample Protocol appended to the 2016 U.S. Model Tax Treaty, the U.S. Department of the Treasury states that in the U.S., the term "pension fund" includes:

> a trust providing pension or retirement benefits under an Internal Revenue Code [§] 401(a) qualified pension plan (which includes a Code section 401(k) plan) and a profit sharing or stock bonus plan, a Code section 403(a) qualified annuity plan, a Code section 403(b) plan, a trust that is an individual retirement account under Code section 408, a Roth individual retirement account under Code section 408A, a simple retirement account under Code section 408(p), a trust providing pension or retirement benefits under a simplified employee pension plan under Code section 408(k), a trust described in section 457(g) providing

If the U.S. wishes to make itself more attractive for foreign investors, one could ask why it should not similarly provide an exemption from U.S. tax whenever a foreign country decides to exempt foreign source investment income of its residents or to tax foreign investment income at a rate below the U.S. withholding tax rate so that the U.S. tax would not be fully creditable. This would, of course, be unworkable as an administrative matter. But, it also suggests that the basis for the reciprocal exemption is not only the investment incentive needed due to the tax exemption in the home country but also the shared social objective of providing an incentive for retirement savings for each country's own residents.[73]

In fact, some argue that the U.S. should extend this treaty approach beyond pension trusts to other types of tax-exempt savings vehicles.[74] For example, both the U.S. and Canada provide tax-exempt savings vehicles for college education and disability-related expenses.[75] The American Chamber of Commerce for Canada argues that they should receive the same reciprocal treaty benefits accorded to pension funds in the U.S.-Canada treaty.[76] It is hard to provide a principled explanation for distinguishing these savings vehicles from pension trusts for purposes of a reciprocal treaty exemption. In both cases, each country provides a tax exemption to promote savings for the same social purpose.[77]

> pension or retirement benefits under a Code section 457(b) plan, and the Thrift Savings Fund (section 7701(j)).

Id.; *see* David W. Powell, *New US Model Tax Treaty Makes Pension-Related Changes*, BENEFITS BRIEF (Feb. 19, 2016), http://www.groom.com/media/publication/1670_New_US_Model_Tax_Treaty_Makes_Pension-Related_Changes.pdf [https://perma.cc/4GZ2-TNBN] [hereinafter *New US Model*] (noting that the 2016 Model Treaty calls for specification of qualifying pension funds in a protocol).

73 *See* Letter of David W. Powell, *supra* note 71.

74 *See* Letter of Jim Yager of the American Chamber of Commerce in Canada to Mark Mazur, Assistant Secretary, *in Group Seeks Relief From Double Taxation Of Cross-Border Savings*, TAX NOTES TODAY, March 4, 2016, LEXIS, 2016 TNT 51-25.

75 *Id.*

76 *Id.* (recommending exemption for a Canadian RESP, RDSP, and TFSA, currently classified by the U.S. as grantor trusts; and reciprocal exemption in Canada for a U.S. 529 plan, an ABLE account or a Roth IRA).

77 *Id.*

B. FIRPTA

Under the recently revised Internal Revenue Code, certain foreign pension trusts are granted an exemption from the application of FIRPTA, which may allow these trusts to be effectively tax exempt with respect to dispositions of U.S. real property or stock of a U.S. real property holding company.[78] However, notwithstanding the inapplicability of FIRPTA, the pension trust would still have to pay U.S. tax and file a tax return if it is engaged in a U.S. trade or business and earns income effectively connected with the trade or business.[79] If the income is earned from a permanent establishment or involves the disposition of real estate, current U.S. treaties and its Model Treaty do not provide protection, even for a foreign pension fund. This Part will assess the newly revised U.S. position.

A FIRPTA exemption for foreign pension trusts has been promoted at least since 2013, and the rationale for the exemption has been that it would equalize the treatment of foreign and U.S. pension trusts and would remove barriers to investment in U.S. infrastructure by foreign pension trusts.[80]

1. Equal Treatment

According to the Joint Committee staff's explanation of a similar provision in the President's 2014 Budget Proposal, the "stated rationale for the proposal is to treat foreign pension funds that may wish to invest in U.S. real property comparably with U.S. pension funds that are exempt from tax."[81] It noted, however, that

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[78] MARTHA GROVES PUGH, TAXATION AND ACCOUNTING, IN RECENT DEVELOPMENTS IN PUBLIC UTILITY, COMMUNICATIONS AND TRANSPORTATION INDUSTRIES 2016 387–88 (Peter V. Lacouture ed., 2016).

[79] This would also include real estate investments for which effectively connected treatment has been elected under section 882(d).

[80] For discussion of earlier efforts to relax the requirements of FIRPTA, see David Herzig, *Elective Taxation on Inbound Real Estate Investment*, 2016 U. ILL. L. REV. 1025, 1038–41 (2016) [hereinafter Herzig, *Elective Taxation*].

[81] STAFF OF JOINT COMM. ON TAXATION, JCS-4-13, DESCRIPTION OF CERTAIN REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2014 BUDGET PROPOSAL 95 (2013) [hereinafter JOINT COMMITTEE, DESCRIPTION]; *see also* Press Release, White House, The "Rebuild America Partnership": The President's Plan to Encourage Private Investment in America's Infrastructure

the intended equality is not complete because the tax on unrelated business income[82] and the rules regarding debt-financed real estate are not applied to foreign pension funds as a condition of exemption (although they remain taxable on effectively connected income).[83]

As discussed above, the argument that the statute itself should provide equal treatment for U.S. qualified funds and foreign funds qualified under a foreign country's law is subject to challenge. But, even accepting that equal treatment is appropriate, it is unclear why equal treatment in the *statute* for foreign and U.S. pensions funds is important in the context of real estate investments but not for other types of investment income such as dividends (which are exempt for a U.S. pension trust, but subject to a 30 percent withholding tax for a foreign pension trust, absent treaty protection).[84] Perhaps the argument could be made that this type of equality is particularly important in the context of FIRPTA because of doubts about the continued appropriateness of FIRPTA.[85] However, that concern might suggest that FIRPTA should be repealed more generally[86] or at least negated by treaty provisions.

(Mar. 29, 2013), https://obamawhitehouse.archives.gov/the-press-office/2013/03/29/rebuild-america-partnership-president-s-plan-encourage-private-investmen [https://perma.cc/YH4E-8K4Q] [hereinafter White House, Infrastructure] (stating that the goal was "to put foreign pension funds on an approximately equal footing" with U.S. pension funds for U.S. real estate investments including infrastructure investments).

[82] For discussion of the UBIT rules, see Ted Dougherty & Jay Laurila, *UBIT Reform Could Help Close the Pension Gap*, TAX NOTES MAG., March 7, 2016, at 1175.

[83] JOINT COMMITTEE, DESCRIPTION, *supra* note 81, at 94. Taylor, *Real Estate*, *supra* note 30, at 998.

[84] *Migrants*, *supra* note 2, at 11–14.

[85] For criticism of FIRPTA, see, for example, Richard L. Kaplan, *Creeping Xenophobia and the Taxation of Foreign-Owned Real Estate*, 71 GEO. L.J. 1091, 1095, 1128 (1983), arguing for repeal; see also *Wither FIRPTA*, *supra* note 58, at 296–97, 301, arguing for reconsideration of rules relating to stock of U.S. real property holding companies. *But see* Herzig, *Elective Taxation*, *supra* note 80, at 1066 (proposing "that FIRPTA should be modified to have mandatory reporting and withholding with high penalties for failure to report").

[86] *See* Taylor, *Real Estate*, *supra* note 30, at 994 (expressing disappointment that legislation proposed in 2015, which led to the PATH provisions, "would not deal comprehensively with foreign investment in U.S. real property"). Taylor suggests that "the only argument for" enacting a FIRPTA exception solely for foreign pension funds "seems to be the perception that foreign pension funds have money to invest." *Id.* at 994. *See also FIRPTA Repeal*, *supra* note 32, for consideration of various repeal options.

A possible alternative argument is that while Congress's intent in enacting FIRPTA was to equalize the treatment of real estate investments by U.S. and foreign investors,[87] Congress inadvertently failed to take into account that, unlike other foreign investors, a foreign pension fund could not claim a foreign tax credit for the FIRPTA tax in its home country.[88]

2. Removing Barriers to Investment

The Joint Committee staff further comments, in its explanation of the President's 2014 Budget Proposal, that "[p]resumably the proposal is intended to encourage greater investment in real estate in the United States by foreign entities, though limited to pension funds."[89] The legislative history of the foreign pension exemption clearly suggests a focus on investment in U.S. infrastructure.[90] A White House press release outlining proposals to increase investment in infrastructure included proposals to encourage greater investment in real estate by foreign pension funds.[91] In its explanation of the president's revenue proposals for fiscal year 2014, the Treasury listed a similar proposal under the heading, "Incentive for Investments in Infrastructure."[92] The version of the proposal

[87] *See* S. REP. NO. 96-504, at 6 (1979) ("The committee believes that it is essential to establish equity of tax treatment in U.S. real property between foreign and domestic investors. The committee does not intend by the provisions of this bill to impose a penalty on foreign investors or to discourage foreign investors from investing in the United States. However, the committee believes that the United States should not continue to provide an inducement through the tax laws for foreign investment in U.S. real property which affords the foreign investor a number of mechanisms to minimize or eliminate his tax on income from the property while at the same time effectively exempting him from U.S. tax on the gain realized on the disposition of the property.").

[88] *Id.*

[89] JOINT COMMITTEE, DESCRIPTION, *supra* note 81, at 95.

[90] FIRPTA is a concern because "most infrastructure assets likely qualify as USRPIs." *FIRPTA*, *supra* note 30, at 1 n.2 (citing IRS Announcement 2008-115, 2008-48 I.R.B. 1228). In this announcement, the IRS stated its intention to issue regulations that would treat at least some government permits relating to infrastructure as U.S. real property interests. See discussion in *FIRPTA Repeal*, *supra* note 32, at 3–4 n.6.

[91] *See* White House, Infrastructure, *supra* note 81.

[92] DEP'T OF TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2014 REVENUE PROPOSALS, at 123 (2013), https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf [https://perma.cc/QTM7-DCTD].

introduced by Representative Bill Owens (D-NY), H.R. 5251, was entitled the "Incentivizing Foreign Investment to Upgrade America's Infrastructure Act."[93] The Bloomberg website reported in 2014 that "Canadian pension funds have quietly pressed Congress to spare them a 35 percent tax that applies to foreigners who invest in U.S. real property, promising a flurry of investment in U.S. public works projects in return, according to lobbyists and others familiar with their overtures."[94] Bloomberg was told by fund representatives that "[c]urrent law essentially prevents foreign investment in many types of public works projects, which yield relatively small but dependable returns over time," and that "[w]hile some real estate investments are worth the tax bite, roads, bridges and other types of public infrastructure make worthwhile investments only if earnings aren't taxed heavily[.]"[95] In this view, since the U.S. needs more investment to repair and expand its infrastructure, the type of investors who are most likely to make such an investment should be encouraged to do so. A pension fund is viewed as a likely investor in that it may be willing to accept stable returns over a long period of time so as to meet long-term obligations to its beneficiaries.

However, the provisions adopted by Congress may not accomplish the objective of encouraging infrastructure investments by foreign pension funds. Direct investment in infrastructure will often produce effectively connected income, which is taxable even apart from FIRPTA.[96] While PATH also improves the treatment

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[93] H.R. 5251, 113th Cong. (2014).

[94] Mark Heller, *Foreign Investors Push Tax Exemption as Route to Fund U.S. Highway Projects*, BLOOMBERG (Aug. 19, 2014), http://kevinbrady.house.gov/news/documentsingle.aspx?DocumentID=396864 [https://perma.cc/9YEB-UNFP].

[95] *Id.*; *see also* White House, Infrastructure, *supra* note 81 (referring to foreign pension funds complaints about FIRPTA); NAT'L MULTIFAMILY HOUSING COUNCIL, Statement for the Record: Hearing on Long-Term Financing of the Highway Trust Fund (June 17, 2015), https://www.nmhc.org/uploadedFiles/Advocacy/Comment_Letters/NMHC-NAA%20Coalition%20Comment%20Letter%20to%20House%20on%20FIRPTA%20and%20Highway%20Trust%20Fund(1).pdf [https://perma.cc/VE9K-CWFG] (statement of Alternative & Direct Investment Securities Association et al.).

[96] See *FIRPTA, supra* note 30, at 1–2, stating that despite section 897(l):

> [if] a QFPF invests in an active USRPI, such as a development or infrastructure project, its gain of the sale of that USRPI will be subject to tax under the usual ECI provisions of [section] 864. The U.S. tax on exit would not apply if the USRPI is not

of foreign pension funds investing in REITs, it is not clear that REITs are generally an appropriate vehicle for infrastructure investment.[97]

> used in a business, such as a triple net lease on an office building, but in that case there would be a 30% withholding tax on the rental income. If the "net election" under [section] 882(d) is made to treat the building as used in a business, the withholding tax will be avoided but the gain on sale would be subject to tax in the same way under [section] 864. Given this dilemma, the significance of the [section] 897(l) exemption will generally be limited to investment in the stock "of a United States real property holding corporation[.]

See also Canadian Pension Plans, *supra* note 30 (noting that despite the infrastructure rationale for section 897(l), the provision "does not extend to ECI investments in general"). Glicklich also explains that "[a]lthough many infrastructure investments result in ECI for foreign investors, such ECI is not generally the kind that results from FIRPTA investments." *Canadian Pension Plans, supra* note 30; *Fields and Dreams*, *supra* note 30, at 3 (explaining that "a foreign investor, including a QFPF, that makes a direct investment in U.S. real estate ... will continue to be subject to the 30% gross withholding tax on passive rents from the property, or to 35% net basis tax on the income from the property"). Semer then concludes that "[a]s a result, most QFPFs will want to structure their investments through REITs ...." *Id.*

[97] See *FIRPTA*, *supra* note 30:

> If a QFPF invests in stock of a USRPHC that is a regular "C" corporation, it will be exempt from tax on any gain realized when it sells such stock .... However, many buyers of USRPIs will not wish to purchase stock of a U.S. corporation with built-in gain at the corporate level, and if they agree to do so will ordinarily extract a significant discount. A better option would be to invest through a REIT, which generally pays no U.S. tax at the corporate level .... But most types of infrastructure assets cannot be held in a REIT in any economically useful way. This is because a REIT cannot own actively managed assets. The best the REIT could do would be to hold the underlying real property and lease it to an operating company. But because rents received from a related person do not qualify as good REIT income, this means that large shareholders of the REIT would not be able to participate in the operating income generated by the property.

Blanchard concludes that the "new [section] 897(l) will be of use to QFPF's primarily to invest in traditional 'REITable' assets and to a lesser extent to invest in the stock of regular 'C' corporations where a stock sale can be accomplished." Blanchard also states, "Where infrastructure is concerned, only the latter option would seem to hold any promise." *Id.*; *see also*, *Canadian Pension Plans*, *supra* note 30 ("[i]nfrastructure investments are rarely suitable to be held in a REIT. Ironically, tax structuring to avoid ECI, such as through leveraged blockers and compliance with [section] 892 remain as critical as ever for

If one assumes that the goal of the PATH provisions went beyond promoting investment in infrastructure, to promoting investment in any type of U.S. real estate, singling out foreign pension funds requires more explanation. One concern may be avoiding the greater revenue loss that would result from a broader exemption from FIRPTA.[98] A more principled reason for focusing on foreign pension funds is that a foreign pension trust is uniquely influenced by the FIRPTA exemption; because of its home country tax exemption, a foreign pension trust may not be able to claim a foreign tax credit for U.S. tax while it is able to invest in its home country without concern for taxation.[99] Depending on the size and nature of the real estate market in its home country, however, investment in local real estate may not be viewed as a substitute for investment in U.S. real estate. As a result, the foreign pension trust may view its alternative real estate options as being in other foreign countries, in which its exemption may also not be recognized.

Moreover, concern about a foreign pension fund's lack of a tax credit for U.S. FIRPTA tax in the home country, due to the fund's exempt status in that country, is not consistent with the statutory definition of a qualified pension fund in the new provisions. The statute does not actually require the fund to be tax-exempt in its home country.[100] If the fund is operated exclusively to provide pension benefits, it can be qualified on one of three *alternative* grounds: (1) that it can receive "contributions [that] ... are deductible or excluded from the gross income of the entity or taxed at a reduced rate" under foreign law or (2) that the "taxation of any investment

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reducing U.S. income tax on foreign pension funds' investments in U.S. infrastructure."); *Fields and Dreams*, *supra* note 30, at 6 (use of REIT for infrastructure "will require that the QFPF be comfortable giving up control of the operator and accepting less than complete alignment between the economic interest of the REIT ... and the operator").

[98] The estimated revenue loss from exempting foreign pension funds from FIRPTA is $789 million over the period 2016–2020. JOINT COMM. ON TAX'N, ESTIMATED BUDGET EFFECTS OF DIVISION Q OF AMENDMENT #2 TO THE SENATE AMENDMENT TO H.R. 2029, THE "PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015," at 6 (Dec. 16, 2015), https://www.jct.gov/publications.html?func=startdown&id=4860 [https://perma.cc/CD8P-JD2X].

[99] This would depend upon the home country's tax treatment of foreign and domestic real estate investments made by a local pension plan. *See Retirement Savings*, *supra* note 64, at 6 (discussing portfolio investments).

[100] *See* I.R.C. § 897(l)(2) (2015).

income of such trust, corporation, organization or arrangement is deferred or [(3)] such income is taxed at a reduced rate."[101] This is in contrast to the definition used by the Treasury in its Model Treaty, which requires tax exemption in the home country.[102]

It is also unclear why, contrary to the rule in the Model Treaty, the special treatment of foreign pension trusts in section 897(l) is limited to those in which a single participant has no more than a 5 percent interest. This limit could be an attempt to include the concept of nondiscrimination in the qualification requirements. However, it would not rule out discrimination if there are at least 21 highly compensated individuals covered by a plan;[103] moreover, there would seem to be no reason to deny this benefit to a pension plan of a company with less than 21 employees.[104] Similarly, it is not clear why, contrary to the rule in the Model Treaty, a foreign IRA-like plan is not included. Perhaps the rationale is that the exemption is not necessary for a small foreign pension trust or foreign IRA because such an entity is not likely to invest in U.S. real estate directly;[105] and, if the foreign entity invests through a publicly traded REIT, it should be eligible for the statutory FIRPTA exception for holders of a not-more-than-10 percent interest.

Congress's decision to adopt this exemption unilaterally might suggest that U.S. pension plans investing in foreign real estate are not subject to a FIRPTA-like provision, so seeking reciprocity is unnecessary. Yet, it seems likely that a foreign country would tax a U.S. pension trust with respect to direct investments in that country's real estate.[106] On the other hand, it is less likely that a

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[101] Blanchard explains that this should probably be interpreted to mean "deductible or excluded" by the employee. *FIRPTA*, *supra* note 30, at 2.

[102] *See supra* note 26 and accompanying text; *but see* U.S.-Germany Treaty, *supra* note 24. Powell comments that "[i]nterestingly, the definition of pension fund [in the 2016 U.S. Model] continues to include a prong that it be generally exempt from income taxation, where it has become more clear in connection with the implementation of FATCA that plans in some jurisdictions are only tax advantaged, not entirely tax exempt." *New US Model*, *supra* note 72, at 2.

[103] Letter from Fiona Galbraith, *supra* note 52, at 7.

[104] *Id.* (noting that "one-third of the Australian superannuation industry is comprised of small or self-managed superannuation funds ('SMSFs'), which are limited by Australian legislation to having no more than four members or beneficiaries" and "it would be anticipated that no SMSF would qualify as a QFPF").

[105] *But see id.* (noting that in the case of "some investment structures … large superannuation funds sometimes co-invest through structures with SMSFs.").

[106] *See* Herzig, *Elective Taxation*, *supra* note 80, at 1064.

foreign country would tax a U.S. pension fund's investment in a local real estate holding company. Although taxation of this type is permitted by most U.S. treaties, it does not appear to be a common practice.[107] However, a recent trend is for developed countries to adopt such an approach.[108] Another explanation is simply that the provision was viewed as so beneficial to the U.S. economy that it was in the U.S. interest to apply it, even to pension plans of countries with which the U.S. was unlikely to be able to negotiate a reciprocal provision in a treaty.[109] In either case, the rationale for this decision should be spelled out more clearly.

CONCLUSION

The U.S. tax treatment of foreign pension plans investing in the U.S. is a topic of much importance since pension plans worldwide are investing large sums outside their home countries and, in particular, in developed countries. The treatment of dividends received by foreign pension plans under current U.S. tax policy seems appropriate. The statute does not provide an exemption, but a treaty conforming to the U.S. Model Treaty would exempt dividends on a reciprocal basis; this type of treaty provision covers retirement savings vehicles (whether large or small) that are tax-exempt in their home country and also identifies the qualifying plans in a treaty appendix. By contrast, section 897(l)'s unilateral exemption from FIRPTA for foreign pension plans is poorly designed to achieve its goal of attracting greater infrastructure investment. It does not negate taxation of gains from infrastructure investments as "effectively connected income." And its definition of a qualified foreign pension plan does not require that the plan be exempt in its home country, and will be difficult to apply to the myriad types of foreign pension plans. Moreover, the legislation precludes negotiation of reciprocal treaty provisions that would benefit U.S. pension funds investing abroad.

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[107] *Id.*

[108] *Id.* at 1064–65 (explaining that "[t]he movement of most developed countries is to expand on the accepted practice of looking through ownership structure to the underlying real property" and discussing developments in India, China, and Peru); *see also Indirect Transfers*, *supra* note 34, at 655–56.

[109] *See* Taylor, *Real Estate*, *supra* note 30, at 998 (criticizing lack of reciprocity in proposed legislation).