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Re: Comments Addressing Proposed Regulations under Section 897(l)

Caisse de depot et placement du Quebec, the New Zealand Super Fund and Ivanhoé Cambridge thank you for the opportunity to provide comments on section 897(l), which exempts qualified foreign pension funds ("**QFPFs**") from the application of section 897 (also known as FIRPTA). Section 897(l) was enacted and signed into law on December 18, 2015 under the Protecting Americans From Tax Hikes Act ("**PATH Act**")[1] and was amended by the Consolidated Appropriations Act of 2018 ("**Appropriations Act**"), signed into law on March 23, 2018.

Treasury issued proposed regulations under section 897(l) on June 6, 2019. We commend Treasury on the proposed regulations, which show an even-handed and flexible approach to section 897(l) that we believe is in line with the intended purpose of encouraging investment in U.S. real estate by foreign pension funds, and which adopt a number of suggestions that we, along with others, had made in a prior submission. Thus, our comments in this submission are limited to issues where we believe the proposed regulations require minor changes or

[1] P.L. 114-113.

clarifications. We respectfully request that Treasury consider the following comments and proposed recommendations before finalizing regulations under section 897(l).

We are a group of government and public pension funds from Canada and New Zealand, invested across multiple asset classes throughout the world, with a significant number of investments in the United States, including U.S. infrastructure and real estate assets. We invest and manage funds for public pension, retirement, disability and employee benefit plans. Each of us, or investors we represent, believe that we should qualify as QFPFs and, where relevant, qualify as retirement, pension or employee benefit funds under income tax treaties with the United States; some of us also qualify as foreign governments under section 892. Collectively, we manage over USD 265 billion in assets as of our most recent determinations.

We anticipate significant growth in our U.S. infrastructure and real estate investments over the next several years, especially if we would qualify as QFPFs. We therefore welcome the enactment of section 897(l) and view it as a clear expression of U.S. policy to encourage investment in U.S. real estate and infrastructure by foreign pension funds. Consistent with this policy, we appreciate that the proposed regulations are in large part clear regarding the definition of QFPF and inclusive of foreign pension funds that have the types of characteristics that make evident they should be included from a policy perspective. However, we respectfully submit several requests for clarification or minor changes to the proposed regulations.

1. Treatment of Ancillary Benefits

The proposed regulations address whether a QFPF may pay benefits other than retirement benefits. They provide that at least 85 percent of the benefits paid out by a QFPF must be retirement or pension benefits, and up to 15 percent of the benefits paid out by the QFPF may be certain qualifying ancillary benefits, such as death or survivor benefits, disability benefits, medical benefits, terminal illness benefits, and unemployment benefits. However, a QFPF may not pay out even a *de minimis* amount of ancillary benefits that are not qualifying ancillary benefits. In addition, the proposed regulations provide that the 15 percent threshold must be tested by determining what benefits the fund reasonably anticipates providing in the future. The preamble to the proposed regulations requests comments regarding whether the 15 percent threshold is appropriate.

First, we believe that the 15 percent threshold is unnecessarily narrow. We understand that Treasury's aim is to ensure that the type of funds that can qualify as QFPFs are truly retirement and pension funds, rather than funds that have a significant other purpose that is not in the nature of a retirement or pension fund. However, several of the benefits listed as ancillary benefits are in the nature of pension type benefits and thus should not be limited. For example, survivor or death benefits (which could be in the form of benefits paid to a designated beneficiary or orphan benefits) are typically paid out to designated beneficiaries of a deceased plan participant, generally in consideration of the fact that had the plan participant not died, such participant would have collected the benefits over time as retirement benefits.

Similarly, when a fund provides for permanent disability benefits, this is usually in recognition of the fact that a disability has in effect forced a participant to retire, just at a younger age than would otherwise be permitted. Thus, in effect, these types of benefits are in the nature of pension benefits and should not be within the ancillary benefit category. Certain types of pension plans may by nature be more likely to pay a larger percentage of benefits of this nature – for example, occupational pension plans for high-risk occupations (such as the military or construction/public works), or plans in countries with later retirement ages and/or lower life expectancies. For example, we are aware of military pension funds that in some years could pay out less than half of their benefits in pure retirement benefits. Similarly, in any given year, a considerable percentage of benefits paid by governmental social security systems can consist of death, survivor, and disability benefits, such that it may not satisfy the 85 percent threshold in such years, and we understand this could be a reasonably common occurrence from time to time across a large number of governmental social security systems around the world. By nature, governmental social security systems – which the legislative history of section 897(l) indicates are intended to generally be in scope – are more likely to provide a social safety-net backstop compared to other pension plans, and thus in many cases these systems may pay out a higher percentage of the types of benefits that would be expected in such cases, such as financial hardship benefits where an individual ceases being able to work. In addition, some other government pension funds may pay out a member's pension benefits at an earlier time, such as upon redundancy or resignation.

We accordingly recommend that those ancillary benefits that are closely related to pensions (such as death benefits, survivor benefits, terminal illness benefits, resignation or redundancy benefits, financial hardship and permanent disability benefits, all of which are paid in recognition of past service and/or the fact that the plan participant is unable to continue working or care for their dependents) be treated as pension or retirement benefits for purposes of the regulations, rather than as ancillary benefits. The result of this rule would be that none of these benefits would count against the 15 percent ancillary benefit limitation. Without such a change to the regulations, it is highly likely that a significant number of pension funds which we believe, as per the intention of the rules, should qualify as QFPFs given their clear pension purpose will in some (if not all) years fail to satisfy the 85 percent retirement / pension benefits test.

Second, in many countries, pension plans are required to offer certain types of benefits that under the proposed regulations may not be qualified benefits. For example, certain countries provide that employment-based pension plans must offer employees the ability to make additional contributions as part of a savings plan or alternatively permit them to make a limited one-off withdrawal to help fund their first home. The policy underlying such a law may be to encourage persons to save for home ownership, children's education, or just to encourage general savings and therefore take pressure off future retirement benefits. However, because the law of the country may require the existing retirement fund structure to also facilitate this type of savings element, the result may be that pension funds organized in certain countries may simply not be able to qualify as QFPFs even though the savings element represents a minor portion of the benefits paid out by the plan. Similarly, plans may be required to permit withdrawals in the case of financial hardship. For example, in New Zealand, plans are required to permit that funds be withdrawn when an employee moves overseas permanently, has a serious or terminal illness, or suffers significant financial hardship.[2]

Similarly, certain governments may require by law that various pension plans, benefits plans and other government functions be set up in such a way that funds that provide for retirement benefits are forced to be pooled with funds that provide for other benefits, such as workers'

[2] For these purposes, significant financial hardship includes (1) being unable to meet minimum living expenses; (2) being unable to meet mortgage repayments on the participant's primary residence, resulting in the mortgage provider enforcing the mortgage; (3) modifying a home to meet special needs because of the participant or a dependent family member having a disability; (4) paying for medical treatment if the participant or a dependent family member becomes ill, has an injury, or requires palliative care; and (5) incurring funeral costs if a dependent family member dies.

compensation benefits, and funds aimed at other government endeavors. The fact that a government has decided to use the same arrangement or "cash pool" to address these various needs should not disqualify a governmental arrangement from being a QFPF provided that its predominant character is that of a pension fund.

We therefore recommend that the final regulations provide (in addition to providing that certain of the qualified ancillary benefits discussed above will be treated as retirement or pension benefits that do not count towards the ancillary benefits threshold) that (i) the definition of ancillary benefits be modified to include any other types of payment, and that (ii) a fund may still qualify as a QFPF if it pays out a *de minimis* amount of non-qualified ancillary benefits (such as no more than 15 percent) and (a) the fund is required by law to provide such benefits or (b) different types of pension plans and non-qualifying plans are required by law to be pooled into one fund / arrangement.

Finally, we recommend an alternative simplified approach for calculating the permitted ancillary benefits threshold. The proposed regulations provide that the calculation must be a reasonable estimate of anticipated future benefits. Many QFPFs do in fact prepare such forecasts; however, these forecasts require complex analysis and therefore some QFPFs may not already prepare them or may not prepare updated forecasts on a regular basis. For such QFPFs, requiring complex forecast models to be built could add unnecessary administrative complexity. We therefore recommend that final regulations provide that a QFPF may calculate its ancillary benefits percentage either using the method under the proposed regulations or will be deemed to satisfy the threshold if the ancillary benefits it paid out over a three-year look-back period does not exceed the threshold. In other words, if the QFPF's ancillary benefits do not exceed the maximum amount either by using a forward-looking estimate or by looking a backward-looking average, the requirement would be satisfied.

Similarly, where a QFPF does rely on its estimate of anticipated future benefits, it would be helpful to clarify that a QFPF's reliance on such forecasts is reasonable if it relies on the most recently completed forecast that the QFPF prepares for its general business purposes in accordance with its internal procedures. In other words, we recommend that Treasury and the IRS clarify that the QFPF does not need to prepare additional forecasts for section 897(l) purposes but can rely on existing internal forecasts prepared for other purposes.

Recommendations

We recommend that final regulations treat ancillary benefits that are closely tied to pension or retirement, such as death or survivor benefits and permanent disability benefits, as pension benefits so that they are not taken into account in determining whether the limit on ancillary benefits is satisfied.

We also recommend that final regulations provide that a QFPF may pay out a *de minimis* amount (such as 15 percent of total benefits) of non-qualified benefits where local law requires retirement or pension funds to offer such non-qualified benefits or, similarly, where a law forces pension plans and non-qualifying plans to pool their assets into the same arrangement.

We further recommend that, in determining the ancillary benefits threshold, a QFPF will be deemed to satisfy the threshold if either (1) it estimates that it will satisfy the threshold based on anticipated future benefits to be paid out, or (2) the ancillary benefits it paid out over a three-year look-back period does not exceed the threshold.

We finally recommend that final regulations clarify that the QFPF can rely on its existing reasonable conventions for determinations of reasonably anticipated future benefits, rather than being required to prepare additional determinations solely for purposes of section 897(l).

2. Clarify Treatment of Early Withdrawals

The proposed regulations are unclear on how early withdrawals from a QFPF should be treated for purposes of determining the amount of retirement or other benefits paid by the QFPF. The issue arises in two contexts. First, plan participants may withdraw from one retirement plan and roll their plan balances over into a different retirement plan, for example due to a change of employment or a beneficiary moving between providers due to performance, fee considerations or the availability of alternative investment classes. Second, plan terms may simply permit (though discourage) early withdrawals of balances in defined contribution plans or may permit participant loans.

In the case of rollover distributions, we believe that these should not be taken into account as "benefits" paid by a plan and thus should be excluded from the determination of the percentage of retirement and ancillary benefits paid out by the plan. Moreover, we recommend that where such rollover distributions are permitted by law, it is sufficient for the distributing QFPF to determine that the distribution is designated for rollover into another plan without having to make a specific determination as to whether that plan itself is a QFPF.

Early withdrawals from a plan that are not tied to a rollover into another retirement plan present a different issue. Arguably, such early withdrawals are the type of nonqualified benefits that the proposed regulations seek to prevent. However, a blanket prohibition on early withdrawals is unduly restrictive – we note that the United States permits plan loans and early withdrawals in certain circumstances, although with punitive financial consequences. For example, the U.S. government's Thrift Savings Plan for government employees permits in-service early withdrawals based on financial hardship, subject to an early withdrawal penalty tax. It also permits plan participants to borrow plan balances, e.g., for purchase of a home. We think it is unlikely that Congressional intent in defining a QFPF would be to so narrowly restrict the types of benefits it could pay that a plan that was set up with features identical to the plan for U.S. government employees would be unable to satisfy the requirements of section 897(l).

Similarly, as pointed out above, plans in countries like New Zealand permit one-off withdrawals for financial hardship or for purchase of a first home without penalty. In such a case, the ability to make an early withdrawal from the plan is narrowly tied to being able to demonstrate a specific need for the early withdrawal. As discussed above, we believe that where such early withdrawals are conditioned upon a particular benefit, the ancillary benefit rule as recommended in Section 1 should adequately address this issue.

Moreover, where a plan permits in-service withdrawals that are not tied to a specific use of the funds (such as the ancillary benefits described above or a roll-over into another retirement savings vehicle), we recommend that where a QFPF permits such pre-retirement in-service withdrawals or loans, any distributions made in this regard will be ignored in determining the benefits paid by the QFPF, provided, that the in-service withdrawals prior to retirement are permissible either under the plan terms or under the relevant law and are subject to financial penalties.

Recommendation

We recommend that final regulations clarify that, in determining the amount of benefits paid out by a QFPF, distributions that are rolled over into another retirement or pension plan are not taken into account.

We also recommend that distributions by a QFPF that are in-service plan withdrawals or loans are not taken into account in determining the amount of benefits paid out by a QFPF, provided that such in-service withdrawals prior to retirement age are permissible either under the plan terms or under the relevant law.

3. Qualified Controlled Entities

Section 897(l) provides that its benefits are available to a QFPF itself, as well as to any entity wholly owned by a QFPF. The proposed regulations are helpful in providing that any entity that is treated as a corporation for U.S. tax purposes that is wholly owned by multiple QFPFs will itself qualify for the section 897(l) exemption. We are supportive of this rule as being clearly in line with the policy intent of section 897(l). The rule reduces the amount of needless structuring that must be undertaken when several QFPFs co-invest in U.S. real estate assets. This is particularly relevant as investors from certain countries may have preferences for legal entities as pooling vehicles that would not be treated as partnerships for U.S. tax purposes.

However, where QFPFs co-invest through a qualified controlled entity, it is crucial that each of the co-investors continue to qualify as QFPFs – if a single co-investor fails to satisfy the requirements (*e.g.*, due to excessive ancillary benefits), then all the other co-investors would also lose the indirect ability to benefit from section 897(l) in such a case. Thus, QFPFs that pool investments in such case will face the need to negotiate complex protections to shield against other co-investors tainting the controlled entity's status, even inadvertently. As discussed above, investing through partnerships may not be feasible because countries may have regulatory restrictions regarding the types of legal entities in which pension funds may invest (and in the case of entities wholly owned by QFPFs forming part of a single government, such entity may be a per se corporation under Treas. Reg. Sec. 301.7701-2(b)(6)).

We accordingly recommend that final regulations provide an inadvertency exception from the all-or-nothing rule for qualified controlled entities. Such a rule could provide that the controlled entity is only eligible for the benefits of section 897(l) to the extent that it is owned by QFPFs, and/or the inadvertency exception only applies for a limited period of time (for example, only for the first and second tax years that it is discovered that an owner has ceased to qualify as a QFPF, following which remedial steps must be taken, such as redeeming the former QFPF's ownership interest, or the former QFPF taking steps to ensure that it recommences qualifying as a QFPF).

Recommendation

We recommend that final regulations provide a rule under which a qualified controlled entity that inadvertently fails to satisfy the requirements for eligibility for section 897(l) due to one of its owners ceasing to be treated as a QFPF be permitted for a limited time to partially benefit from section 897(l) to the extent that it continues to be owned by QFPFs.

4. **Qualified Segregated Accounts**

The proposed regulations provide that the section 897(l) exemption applies only to gain or loss recognized by a qualified holder that is attributable to one or more qualified segregated accounts maintained by the qualified holder. A qualified segregated account is defined as an identifiable pool of assets maintained for the sole purpose of funding qualified benefits to qualified recipients. Such a pool of assets of an eligible fund is only a qualified segregated account if the assets are subject to legal or contractual requirements requiring that all such income and assets are used exclusively to fund the provision of qualified benefits to qualified recipients or to satisfy necessary reasonable expenses of the fund.

We recommend that this general rule be clarified in several ways. First, final regulations should clarify that in the case of an eligible fund that is established by a foreign country, an asset pool will constitute a qualified segregated account even if a change of law could cause the assets to revert to the government rather than the qualified recipients. While unlikely, it is possible that governmental funds such as social security systems could be subject to changes in law where the government decides to reduce benefits and reallocate the funds currently in the fund to other governmental purposes. Such a possibility, however unlikely, should not cause the pool of assets to fail to qualify as a qualified segregated account.

Second, it is possible that a plan, such as an employer sponsored plan, is set up in such a way that participating employees are subject to a minimum service period prior to being fully vested in plan benefits. For example, a defined contribution plan may be set up by an employer where the employer makes contributions to the plan on behalf of the employees; however, if the employee leaves the employer prior to a certain length of service, the employee would forfeit entitlement to such contributions, and they could revert back to the employer. Such a possibility also should not cause the pool of assets to fail to qualify as a qualified segregated account.

Recommendation

We recommend that final regulations clarify that a pool of assets of a government-sponsored QFPF will not fail to be a qualified segregated account merely because of the possibility that a future change in law could impact whether the asset pool will ultimately fully fund benefits to qualified beneficiaries or reasonable plan expenses.

We further recommend that final regulations clarify that a pool of assets of a QFPF will not fail to be a qualified segregated account because assets of the pool may revert to sponsoring employers if employees cease participating in the plan prior to their benefits fully vesting.

Conclusion

We welcome the enactment of section 897(l) and the recently released proposed regulations. As noted previously, we believe that the proposed regulations are extremely helpful to pension funds around the world and adopt a flexible and realistic approach to the definition of a QFPF.

We appreciate the Treasury's and Service's efforts to issue guidance in respect to section 897(l) and hope that you will consider our comments when finalizing the proposed regulations. We would be happy to discuss these comments at your convenience. Thank you again for your time and kind consideration.

Please feel free to contact us with any questions.

Sincerely,

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