

Qualified Foreign Pension Funds

February 3, 2023

After almost four years of waiting, the US Treasury Department and the IRS have finally issued Final Regulations with regard to “qualified foreign pension funds” (“QFPF”) and their tax treatment under US tax laws. The Final Regulations provide welcomed guidance for investments by foreign investors in US real property interests (“USRPI”).

New Regulations

On December 29, 2022, the Treasury Department and the IRS issued final regulations on the exception under Section 897(l) of the Internal Revenue Code (“IRC”) from the Foreign Investment in Real Property Tax Act of 1980 (“FIRPTA”) for a QFPF.

Brief History

In 2015, in order to support the US economy, the Protecting Americans from Tax Hikes Act of 2015 (“PATH Act”) added Section 897(l) IRC, thereby allowing a complete exemption from taxation under

Section 897. Under Section 897(l) IRC, if a foreign investor, such as a foreign pension scheme/fund, qualifies as a QFPF, then such investor will not be subject to withholding on certain dispositions of, and distributions with respect to, certain interests in USRPI. In 2019, the Treasury Department and the IRS released proposed regulations under Section 897(l) IRC. These regulations provided certain guidance on the scope

of the Section 897(l) exemption, including the requirements for an entity to attain the status as a QFPF as well as related withholding tax rules under the IRC.

Interesting Aspects in the Final Regulations

• Structures with non-transparent vehicles:

- QFPFs may invest indirectly in US real property via a corporation organized under the laws of a foreign country (e.g. a Luxembourg société anonyme (S.A.)). This non-transparent vehicle in turn must qualify as a so-called “qualified controlled entity” (“QCE”). Despite many comments to this rule from the fund industry, the Treasury Department and the IRS remained steadfast in the Final Regulations and did not allow a de minimis ownership in a QCE that could be held by an interestholder who is neither a QFPF nor another QCE. In other words, in order to qualify as a QCE, all direct or indirect interestholders in such vehicles must be either QFPFs and other QCEs. No exceptions allowed.

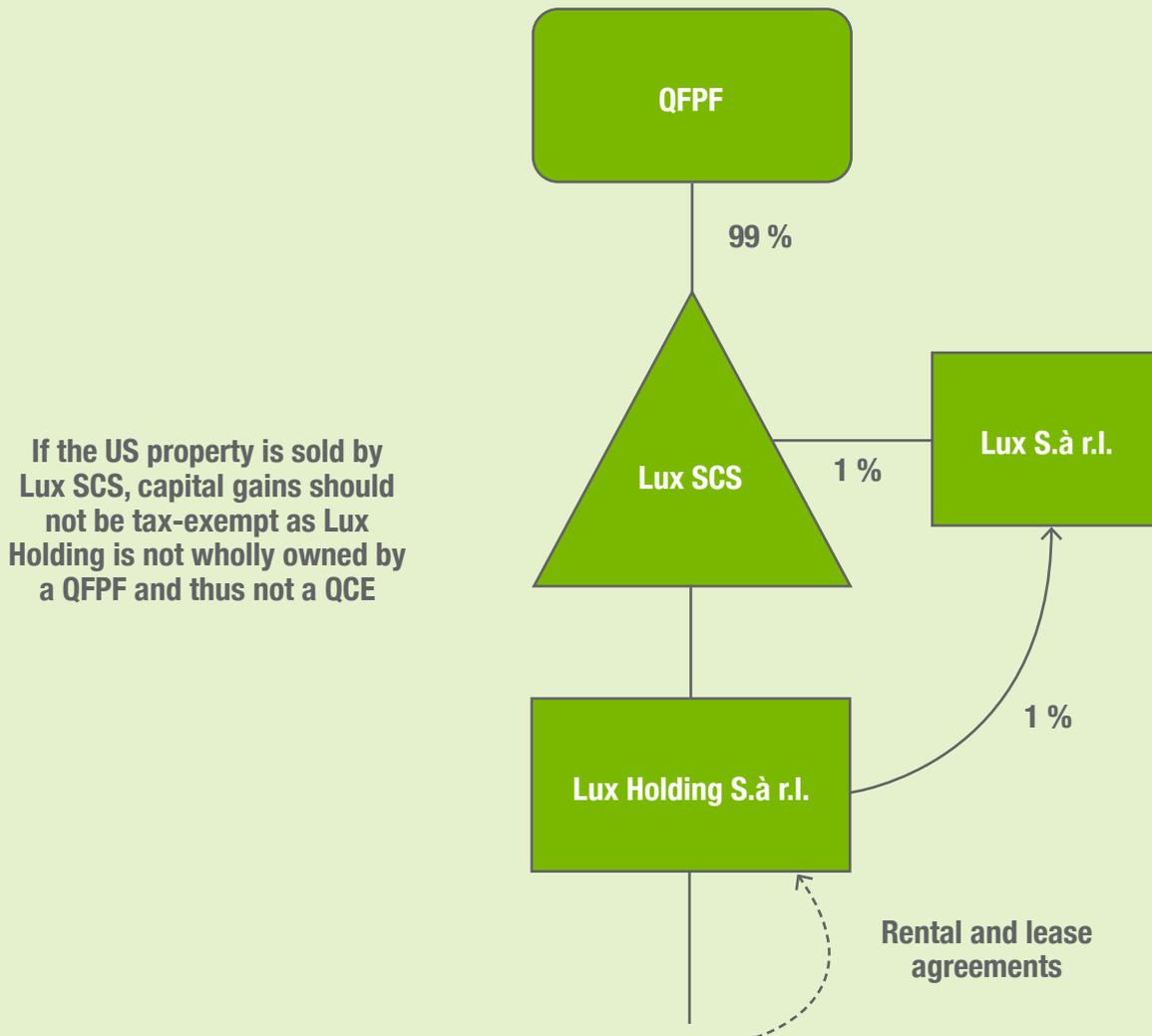


Documents to be informed:

- [Rules and Regulations, December 29, 2022](#)



- In addition, please note that all investors in a non-transparent structure must qualify as a QFPF if the Section 897(l) exception is to apply. If one investor ceases to qualify as a QFPF, then the non-transparent vehicle is no longer a QCE (as no longer held 100 % by qualified holders) and thus the exception is denied to all investors in that structure, even if the other investors continue to qualify as QFPFs. This may give rise to liability on the part of the non-qualifying investor according to the fund's governing documents (e.g. Subscription Agreement). One bad apple will spoil the whole bunch!



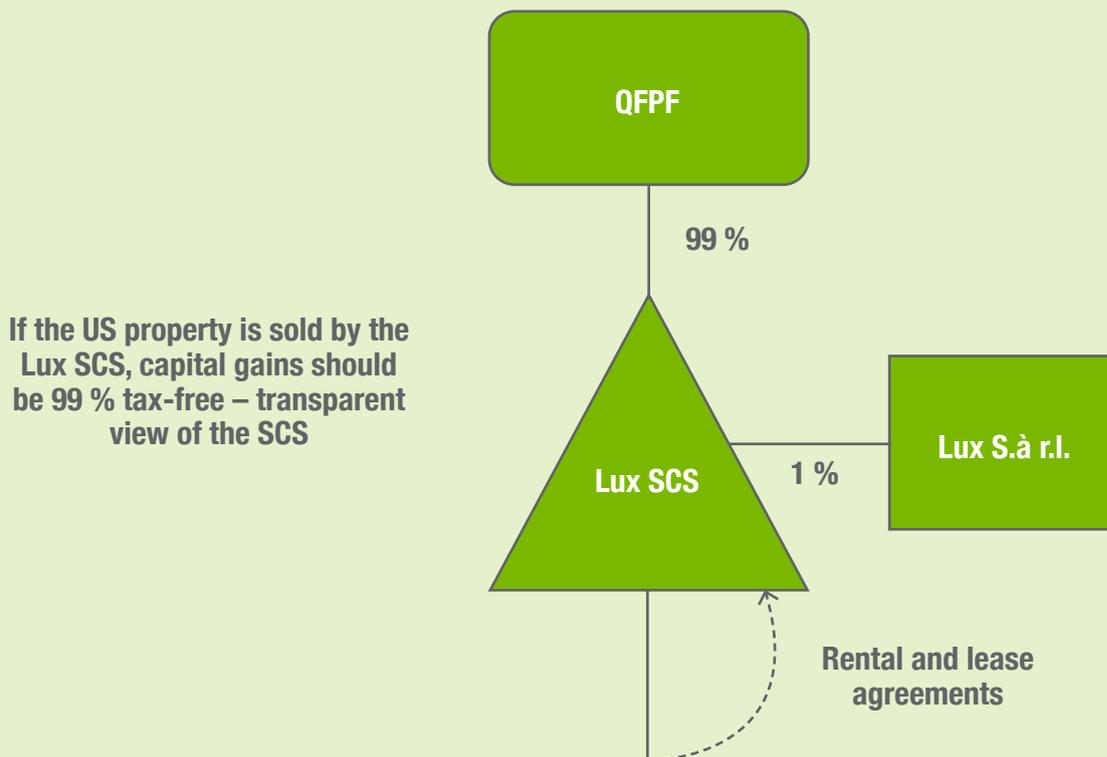
- **Structures with transparent vehicles:**

- QFPFs may invest indirectly in US real property via a foreign partnership (e.g. a Luxembourg société en commandite simple (SCS)). In such a structure, a QFPF is treated as if it were a direct investor in USRPI. This means that even if the general partner of a partnership is not a qualified holder (i.e. not a QCE), then the limited partners are still eligible for the Section 897(l) exception for their (proportionate) distributive share of FIRPTA gains, provided that the limited partners qualify as QFPFs.
- The Final Regulations (and the 2019 Regulations) also provide a specific example of a structure in which the general partner also acts as asset manager and “receives a profit interest in the partnership that is reasonable in light of [its] management activities”. In this example, the



limited partners qualifying as QFPF are still eligible for the exception under Section 897(l) for their distributive share. The general partner is not.

- **Check-the-Box:** Please note that if a foreign partnership has “checked the box” in order to be treated as a corporation for US federal tax purposes, this could arguably require that the partnership must now qualify as a QCE, i.e. it may be held only by limited partners who are QFPFs and/or QCEs AND the general partner must also qualify as a QCE. If the general partner does not, then the Section 897(l) exception for the limited partners may not be available.



- **100 % and 85 % tests remain as before:** According to the Regulations, in order to qualify as a QFPF, an eligible fund had to ensure that 100 % of all of the qualified benefits (i.e. retirement, pension or ancillary benefits) provided by such fund are to qualified recipients. Moreover, at least 85 % of the present value of the qualified benefits the fund reasonably expects to provide to qualified recipients in the future are retirement and pension benefits.
- **However, a new 5 % de minimis rule was introduced:** The Final Regulations create a 5 % bucket for non-ancillary benefits, i.e. 5 % of the present value of the benefits do not have to be either ancillary or retirement/pension benefits and will not prevent qualification as a QFPF.
- **More detailed list of ancillary benefits:** The Final Regulations provide a more detailed list of what constitutes an ancillary benefit and thereby allows an easier determination of the 5 % non-ancillary bucket. The list does not list all types of benefits, but one could argue that occupational disability benefits (Berufsunfähigkeit) do fall under the list of ancillary benefits.
- **Record-keeping requirement:** The Final Regulations require that a QFPF claiming the Section 897(l) exception must have records sufficient to establish the requirement for its QFPF status, such as the above-mentioned 100 %, 85 % and 5 % thresholds.



Certification as QFPF

- **Form W-8EXP:** The practical issue of how an eligible fund certifies that it qualifies as a QFPF (e.g. vis-à-vis an investment fund) has not yet been resolved by the IRS. The IRS is expected to revise the Form W-8EXP (“Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding or Reporting”) to allow such certification, but as of the date on this beinformed, only the 2017 version of the Form W-8EXP is available on the IRS website. Revised Instructions for the Form W-8EXP are also expected.
- **Self-Certification:** Until then, investors qualifying as QFPFs will need to continue to submit a self-certification. Please note that this self-certification is signed under penalty of perjury, just as if it were an official W-8 Form.
- **Other W-8 Forms:** Please also note that in the future, investors qualifying as QFPFs can expect to submit Form W-8EXP (for QFPF status) as well as Form W-8BEN-E (for FATCA and/or DTT treaty status) to their investment funds.

Our Recommendations

- **As investor:**
 - If QFPF status was uncertain under the 2019 Regulations, we suggest checking with bepartners to determine if your entity is a QFPF under the Final Regulations.
 - Maintain supporting documentation to satisfy the recordkeeping rule.
 - Continue to monitor thresholds, if applicable.
 - Expect to receive requests to provide Form W-8EXP from funds once it has been revised by the IRS.
- **As fund sponsor:** Check with bepartners regarding the best fund structure (Feeder, Master, etc.), given the circle of investors on which you are focusing, for safeguarding QFPF benefits.

 **in touch: Any questions? Please do not hesitate to contact us!**



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