January 2023

Follow @Paul_Hastings

Treasury Issues New Guidance Affecting Sovereign Wealth Funds, Qualified Foreign Pension Funds, and Domestically Controlled REITs and RICs

By Lucas Rachuba, Thomas S. Wisialowski, Joseph P. Opich, & Kami LaBerge

On December 28, 2022, the Treasury Department and the IRS issued proposed regulations (the "Proposed Regulations") on the treatment of qualified foreign pension funds ("QFPFs") for purposes of the exemption from taxation for foreign governments under Section 892 of the U.S. Internal Revenue Code of 1986, as amended (the "Code"). The Proposed Regulations also provide guidance on how QFPFs are treated for purposes of certain qualified investment entity ("QIE")[1] rules and when a QIE is domestically controlled such that it will not constitute a United States real property interest ("USRPI").

On the same date, the Treasury Department and the IRS also issued final regulations under Code Section 897(l) (the "Final QFPF Regulations") addressing general QFPF qualification issues. With certain notable exceptions discussed below, the Final Regulations adopt the previously proposed regulations published on June 7, 2019 (the "2019 Proposed QFPF Regulations").

In addition, the Treasury Department and the IRS announced that they are reopening the comment period for proposed regulations issued in 2011 that provide guidance to determine when a foreign government's income from U.S. investments is exempt from U.S. taxation under Code Section 892.

Background on Code Sections 892 and 897

Code Section 892 and the temporary regulations issued thereunder provide that the income of foreign governments (and their controlled entities[2]) derived from investments in the United States in stocks, bonds, or other domestic securities is, in general, exempt from U.S. federal taxation. However, this exemption does not apply to income of a foreign government that is (i) derived from the conduct of commercial activities (whether within or outside of the United States), (ii) received by a controlled commercial entity ("CCE") or received (directly or indirectly) from a CCE, or (iii) derived from the disposition of an interest in a CCE.

Under Code Section 897 (part of the so-called "FIRPTA" provisions), gain or loss derived by a nonresident alien individual or a foreign corporation from the disposition of a USRPI is taken into account as if the foreign corporation or nonresident alien were engaged in a trade or business in the United States and such gain or loss were effectively connected with the trade or business. Thus, such non-US person may

be withheld on and may be subject to US net basis taxation and filing requirements. An interest (other than solely as a creditor) in a United States real property holding corporation ("USRPHC") (defined as a corporation if the fair market value of its USRPIs is 50% or more of the fair market value of its USRPIs, its non-U.S. real property interests, and its other assets held for use in a trade or business) is a USRPI.

Code Section 897(l) provides that neither a QFPF nor a wholly owned subsidiary of a QFPF (a "qualified controlled entity," or a "QCE") is treated as a nonresident alien individual or a foreign corporation for purposes of the general rule of Code Section 897. The 2019 Proposed QFPF Regulations provided that a QCE has to be a foreign corporation or a foreign trust but also expanded the concept to allow ownership of a QCE by multiple QFPFs and other QCEs. A QFPF or a QCE is, effectively, not subject to FIRPTA taxation.

> ***Observation****: Investors should be aware, however, that QFPF/QCE status does not provide protection from U.S. taxation of income (including USRPI gain) that is otherwise effectively connected with a U.S. trade or business. Consequently, an investment in a U.S. operating partnership (either directly or through a flow-through entity) may generate U.S. net basis taxation even with respect to gain on the disposition of USRPIs, provided that such gain has a sufficient connection to the partnership's operations.*

Under Code Section 897(h)(2), an interest in a domestically controlled QIE is not a USRPI (the "DC-QIE Exception"). A "domestically controlled QIE" means any real estate investment trust ("REIT") or "regulated investment company" ("RIC") in which less than 50% in value of the stock was held (directly or indirectly) by foreign persons at all times during a relevant testing period (generally a five-year look-back). In addition, Code Section 897(h)(3) requires a domestically controlled QIE to recognize gain on a distribution of a USRPI to the extent of its foreign ownership percentage. The term "foreign ownership percentage" means the percentage of QIE stock that was held (directly or indirectly) by foreign persons at the time during a relevant testing period during which the direct and indirect ownership of stock by foreign persons was greatest. This provision is, in real estate circles, also known as the "DC-REIT" exception.

The Proposed Regulations

The Proposed Regulations provide the following additional guidance regarding the above rules:

Code Section 892: Coordination with the Code Section 897(l) Exemption and Exceptions to the "USRPHC Trap"

Treasury Regulation Section 1.892-5T(b)(1), promulgated under Code Section 892, treats a USRPHC or, importantly, a foreign corporation that would be a USRPHC if it were a United States corporation, as engaged in commercial activity. Thus, were a non-U.S. controlled entity of a foreign government to be treated as a USRPHC under this rule, such an entity would automatically also be treated as a CCE. And a CCE (and income from a CCE) does not, as noted above, qualify for the benefits of Code Section 892.

> ***Observation****: This has been referred to as the "USRPHC trap." For example, under this rule, a controlled Canadian subsidiary of the Canadian government could recognize gain on the disposition of its USRPHC stock which gain is protected by Code Section 892, but only for so long as such subsidiary USRPIs do not constitute 50% of the fair market value of the sum of its USRPIs, its non-U.S. real property interests, and its other assets held for use in a trade or business. For this reason, many "892 investors" request valuation statements from real estate fund sponsors even if such sponsors invest entirely through U.S. "blockers."*

Under this rule, a foreign government-controlled QFPF or its QCE could be deemed to be a CCE for purposes of Code Section 892 if such entity were treated as a "deemed" USRPHC (i.e., if it owned too much USRPIs). Given that the purpose of the QFPF regime is to encourage U.S. real estate investment

by foreign pensions, the government concluded that Treasury Regulation Section 1.892-5T(b)(1) should not apply to either a QFPF or a QCE. Therefore, the Proposed Regulations provide that a QFPF or QCE will not be treated as a CCE as a result of the operation of this rule.[3]

Although the government has not eliminated this "USRPHC trap" altogether, it chose in the Proposed Regulations to provide another exception for a corporation (U.S. or foreign) that would be deemed a USRPHC solely by reason of its direct or indirect ownership interest in one or more other corporations that themselves are not controlled by a foreign government.

> ***Observation**: This exception goes beyond pension funds. As a result, a foreign government will not be deemed invested in a CCE if that government owns an interest in a controlled entity which would be deemed a USRPHC by reason of non-control interests in lower-tier entities. Thus, in the above example, the Canadian subsidiary would not be a CCE solely by reason of its ownership in U.S. blocker corporations provided each such blocker is not otherwise controlled by the foreign government. However, holding other USRPIs such as actual real estate would not be protected.[4]*

QFPF/QCE Status for Purposes of the "Domestically Controlled" Exception

Although Code Section 897(l) provides that a QFPF is not treated as a nonresident alien individual or a foreign corporation for purposes of Code Section 897, it does not expressly provide that a QFPF or QCE is not treated as a "foreign person" for purposes of the DC-QIE Exception.[5] The Proposed Regulations state that both QFPFs and QCEs, in fact, are foreign persons for purposes of this exception.

> ***Observation**: This regulatory language effectively precludes non-U.S. persons other than QFPFs and QCEs from bootstrapping off of the status of a QFPF (or a QCE) for purposes of fitting under the DC-QIE exception.*

Other Stockholdings for Purposes of the "Domestically Controlled" Exception

In addition to the above-mentioned QFPF-related rules, the Proposed Regulations also specify the status of other holders and provide general guidance on when stock of a QIE is "held directly or indirectly" by foreign persons for purposes of determining whether a REIT or a RIC is "domestically controlled."

The Proposed Regulations define stock that is held "indirectly" by taking into account stock of a QIE held through certain entities under a limited "look-through" approach that looks through to the owners of "look-through persons." Such look-through persons are entities that are generally not themselves subject to U.S. federal income taxes, such as partnerships, S corporations, REITs, RICs, and trusts.

The Proposed Regulations further provide that for purposes of the DC-QIE exception:

- with respect to a publicly traded class of a REIT or RIC, a person holding less than 5% of such class of the REIT or RIC at all times during the testing period will be presumed to be a U.S. person (and will not be looked through) unless the REIT or RIC has actual knowledge that such holder is a foreign person;[6]

> ***Observation**: The value of this presumption seems limited, given that the REIT or RIC would seemingly also have to identify such shareholder's 5-year ownership history*

- a publicly traded REIT or RIC[7] is treated as a foreign person (and will not be looked through) unless such REIT or RIC is itself domestically controlled, in which case it will be treated as a U.S. person (and will not be looked through);[8] and

- international organizations are treated as foreign persons.

Perhaps most notably, under the Proposed Regulations, a non-publicly-traded U.S. "Subchapter C" corporation will also be considered a look-through person if foreign persons hold 25% or more of the fair market value of the corporation's outstanding stock.

> ***Observation**: Some foreign investors have taken the position that, for purposes of determining whether a REIT or a RIC is "domestically-controlled," one need not look through a Subchapter C-corporation. Thus, e.g., a REIT majority owned by a U.S Subchapter C corporation[9] could, under this theory, be treated as a DC-QIE and the sale of the minority shares in it by a foreign person would not be subject to U.S. tax even if the same foreign person owned 100% of the U.S. Subchapter C-corporation. Less dramatically, a foreign-owned C-corporation could previously be used to "get over" the 50% U.S. ownership threshold. The Proposed Regulations reject the validity of this position.*

The validity of this Treasury and IRS position is uncertain. Specifically, the statute is not written to provide for constructive ownership rules which would seem to be necessary (in the absence of a broad grant of authority to the Treasury) in order to look through a taxable corporation and produce the government's desired result. A further, more prosaic, issue is presented by the fact that a contrary position seems to follow from the government's own regulations.[10] Moreover, the last time Congress expounded on these provisions (in the 2015 PATH Act), it did not provide for rules reaching this outcome.

> ***Observation**: The IRS has previously issued a private letter ruling (PLR 200923001) permitting foreign owned U.S. C-corporations to be treated as U.S. persons for the "domestically controlled" test. A private ruling may only be relied on by the taxpayer to whom it was granted, but it is generally seen as indicative of IRS's current views.[11]*

Distributions by DC-QIEs: Calculating the Foreign Ownership Percentage

The Proposed Regulations provide that for purposes of calculating the "foreign ownership percentage" (used to determine the extent to which a DC-QIE must recognize gain on a distribution of a USRPI), the determination of the QIE stock that was held directly or indirectly by foreign persons (and, is therefore, part of the foreign ownership percentage of such QIE) is made under the same rules that apply for purposes of determining whether a QIE itself is domestically controlled.

Effective Dates of the Rules in the Proposed Regulations

The Proposed Regulations under Code Section 892 will apply to taxable years ending on or after December 28, 2022, and taxpayers may rely on these proposed regulations until final regulations are adopted.

While the Proposed Regulations under Code Section 897 will apply only to transactions entered into or modified on or after the date final regulations are published in the Federal Register, the Treasury Department and the IRS have indicated that they believe that the rules for determining whether a QIE is domestically controlled may be relevant to determine QIE ownership during periods prior to that date to the extent that the testing period (i.e., usually 5 years) relating to a transaction entered into after that date includes prior periods.

Moreover, the Treasury Department and the IRS have indicated that the IRS may challenge positions contrary to the domestically controlled QIE-related rules stated in the Proposed Regulations before the issuance of final regulations.

The Final QFPF Regulations

The Final QFPF Regulations generally adopt the 2019 Proposed QFPF Regulations. In responding to taxpayer comments, Treasury and the IRS explicitly:

- refused to provide for *a de minimis* exception to the requirement that a QCE be wholly-owned by QFPFs or other QCEs;
- rejected the suggestion that QFPFs and QCEs be allowed to benefit from their status via investments in entities other than QCEs (with the exception of partnerships); and

***Observation**: Although look-through is available for investors in partnerships, certain entities that could otherwise be treated as partnerships are viewed by U.S. law instead as per se corporations. Such entities include entities wholly owned by foreign governments (including foreign governmental pension funds). This has historically been an issue for Code Section 892 eligible investors investing through entities that would not qualify as controlled entities (e.g., because they are organized outside of the investor's home jurisdiction). With respect to the more flexible Code Section 897(l), we would expect such an entity to qualify as a QCE provided all its governmental owners are QFPFs and QCEs themselves and it otherwise meets the requirements of the QCE rules.*

- refused to allow a QCE which fails such qualification as a result of one of its members failing QFPF or QCE requirements to continue to benefit the failed QCE's other (otherwise qualifying) members.

Qualified Holder Rule Remains in Place

The 2019 Proposed QFPF Regulations provided that a QFPF or QCE (a "qualified holder") for purposes of the Code Section 897(l) exemption does not include any entity or governmental unit that, at any time during the relevant "testing period" (the shortest of (i) the period beginning on December 18, 2015[12] and ending on the date of the disposition or distribution, (ii) the 10-year period ending on the date of the disposition or distribution, or (iii) the period in which the entity was in existence), determined without regard to this limitation, was not a QFPF, a part of a QFPF, or a QCE (the "Qualified Holder Rule").[13] The Final QFPF Regulations set forth the following two alternative tests to determine whether a QFPF or QCE is a qualified holder:

- the QFPF or QCE must not own any USRPIs as of the earliest date during an uninterrupted period (ending on the date of the disposition or distribution) during which such entity qualified as a QFPF or QCE; or
- the QFPF or QCE satisfies the above testing period requirement.

***Observation**: As noted in the preamble to the 2019 Proposed QFPF Regulations, the Qualified Holder Rule is designed to prevent Code Section 897(l) from applying to an entity that is not initially a QCE, that holds existing USRPIs and that becomes a QCE as a result of a subsequent acquisition by a QFPF. For example, a QFPF could acquire a non-U.S. corporation that held USRPIs and which corporation became a QCE as a result of the acquisition. The same result could (but for the Qualified Holder Rule) apply to a fund that is not a QFPF that holds USPRIs and then becomes a QFPF. In other words, the rule was designed to ensure that qualifying for Code Section 897(l) does not remove previously taxable gain from U.S. taxing jurisdiction by a status change of the taxpayer (providing for an up to 10-year "cooling off" period). The Final QFPF Regulations essentially preserve the Qualified Holder Rule and do not adopt any potential alternatives (such as mark to market or tracing).*

The Final QFPF Regulations also include rules that allow for:

- a reasonable interpretation of the rules during the transition period between December 18, 2015 and (i) with respect to a QCE, June 6, 2019 (i.e., the publication date of the 2019 Proposed QFPF Regulations) or (ii) with respect to a QFPF, December 22, 2022 (i.e., the publication date of the Final QFPF Regulations), and
- a QCE to disregard a *de minimis* interest owned by any person that provides services to the QCE from December 18, 2015 to February 27, 2023 provided that such interest has been eliminated prior to the disposition or distribution to which Code Section 897(l) is to apply.

Qualified Segregated Accounts

Under the 2019 Proposed QFPF Regulations, a qualified holder is exempt from the general rule of Code Section 897 only with respect to gain or loss that is attributable to one or more qualified segregated accounts maintained by the qualified holder ("QSAs"). In general those regulations required that a QSA's income and assets be used exclusively for the sole purpose of providing qualified benefits (generally retirement, pension and ancillary benefits) to qualified beneficiaries (generally, employees, former employees, and their designees).

The Final QFPF Regulations clarify that a QSA that is held by an eligible fund is treated as maintained for the sole purpose of funding qualified benefits to be provided to qualified recipients notwithstanding that funds may revert to the governmental unit or employer such as upon plan termination or dissolution (after all obligations to qualified recipients and creditors have been satisfied) or in case of a vesting failure. Such reversions are now permitted provided that they are in accordance with applicable foreign law and only if contributions to the plan are not more than what is reasonably necessary to fund the qualified benefits to be provided to qualified recipients (i.e., the Treasury does not want funds to be purposefully overfunded relative to the expected payouts and still qualify for QFPF/QCE status).

Observation*: The 2019 Proposed QFPF Regulations previously provided an exception for the assets and income inuring to the benefit of the government by virtue of "escheat or similar laws". The Final QFPF Regulations also retain this exception.*

Requirements Applicable to QFPFs

The 2019 Proposed QFPF Regulations allowed pension funds established by one or more employers and government-sponsored pension funds to be considered QFPFs. The Final QFPF Regulations provide the following clarifications and modifications:

- an eligible fund may be established by, *or at the direction of*, a foreign jurisdiction for purposes of qualifying as a government-established fund;

Observation*: The regulatory scheme provides for both government-established funds and employer funds. Previously, commentators expressed concern that certain retirement accounts (that are not employer funds) may be mandated by the government but actually established by a private pension administrator and managed by private investment managers. The Final QFPF Regulations clarify that such a hybrid arrangement will, in fact, be viewed as "established by" the government.*[14]

- an eligible fund can be established by a governmental unit acting in its capacity as an employer and will be treated as an employer fund.

***Observation**: The regulatory scheme provides for both government-established funds and employer funds. Commentators asked for clarification about funds established by the government not for the population at large, but rather for government employees.*

The 2019 Proposed QFPF Regulations required that all of the benefits that an eligible fund provides are "qualified benefits" to qualified recipients (the ''100% Test''), and that at least 85 percent of the present value of the qualified benefits that the eligible fund reasonably expects to provide in the future are retirement or pension benefits (the ''85% Test''). For this purpose, qualified benefits were defined as retirement, pension or ancillary benefits.

The Final QFPF Regulations change these rules in several respects:

- they create a new *de minimis* rule that allows up to 5 percent of the present value of the benefits the eligible fund reasonably expects to provide to qualified recipients in the future to be neither ancillary nor retirement/pension benefits ("5% Limit");[15]

***Observation**: This is a very welcome change given that under the 2019 Proposed QFPF Regulations, the provision of any impermissible benefits risked the status of the entire QFPF. One example cited by the preamble to the regulations includes the benefit of allowing limited withdrawals to fund a first home.*

- the Final QFPF Regulations also provide a specific definition of retirement and pension benefits and expand the definition of ancillary benefits,[16] all of which makes it easier not to exceed the 5% Limit;
- the regulations also provide a "tie-breaker" rule whereby benefits that could qualify as either pension/retirement or ancillary benefits are deemed to be in the former category, which makes it easier to meet the 85% Test;
- for purposes of determining whether an eligible fund meets the 85% Test and the 5% Limit, any reasonable method may be used to determine the present value of benefits, provided that the determination must be made at least annually; the fund may also use a 48-month alternative calculation test, which is satisfied if the average of the present values of the retirement and pension benefits (based on values, not percentages) the eligible fund reasonably expected to provide over its life, as determined by the valuations performed over the 48 months preceding (and including) the most recent present valuation, satisfies the 85% Test; and
- an eligible fund must use its *most recent* present value determination (either under the basic test or the alternative 48-month test) with respect to dispositions of USRPIs or distributions described in Code Section 897(h) that occur during the twelve months that succeed that present value determination, or until a new present value determination is made (whichever occurs first).

The Final QFPF Regulations also clarify that certain types of loans to participants, rollover distributions and hardship withdrawals are not taken into account for purposes of the 100% Test, the 85% Test, or the 5% Limit. The Final QFPF Regulations also provide that, with respect to employer funds, individuals who were never employees (or spouses or designees) but that are otherwise eligible under the plan may constitute qualified beneficiaries provided such persons not exceed 5% of the overall eligible participants and provided that they do not have a right to more than 5% of the fund's assets or income. To benefit from this rule, a fund must make these calculations at least annually and, as with the 5% Test described

above, must use its most recent determination with respect to dispositions of USRPIs or distributions described in Code Section 897(h) that occur during the twelve months after that determination, or until a new determination is made (whichever occurs first). The preamble also confirms that with respect to government funds any person eligible to participate in such a fund is a qualified participant.

Further, the information-reporting requirement of Code Section 897(l) is satisfied if a fund annually provides information about the amount of qualified benefits provided to qualified recipients to the relevant tax authorities or other relevant governmental units, or if such information is otherwise available to the relevant tax authorities or other relevant governmental units.

> ***Observation****: The 2019 QFPF Regulations created a potential qualification issue where a fund was required to provide information to the relevant local governmental authorities but did not itself actually do so (e.g., because the information was otherwise available).*

As per the statute, a QFPF must be subject to preferential tax treatment in its home jurisdiction. This requirement may be met either because of a preferential treatment of contributions to the fund or by reason of the preferential treatment of the fund's investment income. A question, answered in the negative by the preamble 2019 QFPF Proposed Regulations, was whether preferences in subnational taxes count for this purpose. The Final QFPF Regulations provide that preferential subnational tax treatment may satisfy the requirement of Code Section 897 to the extent that those taxes are covered under an income tax treaty with the United States.

> ***Observation****: This appears to be a narrow exception seemingly applicable only to a subnational pension scheme in a subnational jurisdiction whose taxes are covered under a U.S. income tax treaty (e.g., the U.S.-Swiss treaty covers cantonal and local income taxes) but which scheme is not subject to a preferential tax treatment on the national level.*

Withholding Rules

Under the Final QFPF Regulations, a qualified holder and a foreign partnership all of the interests of which are held by qualified holders (including through one or more partnerships) may certify its status as a "withholding qualified holder." The effect of such certification is that such person is not treated as a foreign person for purposes of withholding under Code Section 1445 (and Code Section 1446, to the extent relevant). The IRS has indicated that it intends to release a revised Form W-8EXP on which this certification can be made. Until that revised form is released, a transferor should use a certification of non-foreign status described in Treasury Regulations Section 1.1445-2(b)(2)(i) (but not a Form W-9) to establish its status as a withholding qualified holder for these purposes.

> ***Observation****: Thus, a foreign partnership, wholly owned by QFPFs and QCEs, including through other partnerships (U.S. or foreign) can avoid withholding on the sale of USRPIs. A U.S. partnership selling a USRPI will not itself be subject to withholding but will then need either to withhold or, to avoid withholding, obtain appropriate certification from its partners.*

The Final QFPF Regulations also provide that such withholding qualified holders are not subject to Code Section 1445 tax on distributions from USRPHCs that are not treated as dividends or on distributions from REITs or other QIEs that are capital gain dividends that are treated as gain attributable to the sale or exchange of USRPIs.

Dividends from USRPHCs and dividends from REITs or other QIEs that are *not* capital gain dividends continue to be subject to withholding under Code Section 1441 (i.e., the general up-to-30% rate for U.S. dividend withholding).

In addition, withholding will apply under Code Section 1441 to the extent that a capital gain dividend from a REIT or other QIE is excluded from withholding under Code Section 1445 because it is made with respect to stock that is regularly traded on an established securities market in the United States to an individual or corporation that did not own more than 5% of the stock.

> ***Observation**: Thus, a QFPF or a QCE is still subject to regular U.S. withholding tax on dividends from publicly traded REITs or RICs if such QFPF or QCE did not own more than 5% of the publicly traded class of the REIT or RIC (during the 1-year period ending on the date of the distribution). This is so even if the dividend could be traced to USRPIs.*

Effective Dates of the Rules in the Final QFPF Regulations

The Final QFPF Regulations generally apply with respect to dispositions of USRPIs and distributions described in Code Section 897(h) occurring on or after December 29, 2022. As noted above, certain rules will apply with respect to dispositions and distributions occurring on or after June 6, 2019. In addition, an eligible fund may opt to apply the Final QFPF Regulations to dispositions and distributions occurring on or after December 18, 2015, provided that the eligible fund and all other relevant persons consistently apply all applicable rules for all relevant years.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

San Francisco

Lucas M. Rachuba
1.415.856.7060
lucasrachuba@paulhastings.com

Los Angeles

Kami LaBerge
1.213.683.6159
kamilaberge@paulhastings.com

Palo Alto

Thomas S. Wisialowski
1.650.320.1820
thomaswisialowski@paulhastings.com

New York

Joseph P. Opich
1.212.318.6596
josephopich@paulhastings.com

[1] A QIE is subject to special distribution rules. A QIE includes (1) any REIT and (2) a RIC that is a USRPHC or that would be a USRPHC but for the fact that it is able to rely on the domestically controlled exception or the publicly traded class of shares exception.

[2] A "controlled entity" may qualify for the benefits of Code Section 892. However, under temporary Code Section 892 regulations such qualification would evaporate if the entity were engaged in any commercial activity anywhere in the world (even if entirely unrelated to the income for which Code Section 892 would otherwise be sought). This is in distinction to the foreign government and its "integral parts" that may be taxed on U.S. commercial activity income but whose receipt of such income will not remove the protection such foreign government enjoys with respect to other income. The 2011 proposed Code Section 892 regulations would liberalize this regime.

[3] Note that it is possible for a controlled entity to include a separately organized pension trust that is not a QFPF. Treas. Regs. § 1.892-2T(c). This new exception would not protect such a trust.

[4] Whatever the wisdom of this choice, such position is consistent with Treasury Regulations Section 1.892-3T(a)(1) (final paragraph).

Paul Hastings LLP

Stay Current is published solely for the interests of friends and clients of Paul Hastings LLP and should in no way be relied upon or construed as legal advice. The views expressed in this publication reflect those of the authors and not necessarily the views of Paul Hastings. For specific information on recent developments or particular factual situations, the opinion of legal counsel should be sought. These materials may be considered ATTORNEY ADVERTISING in some jurisdictions. Paul Hastings is a limited liability partnership. Copyright © 2023 Paul Hastings LLP.

[5] The original 2015 text of Code Section 897(l) provided that Code Section 897 "does not apply to any [USRPI] held . . . or any distribution received from a [REIT], by a [QFPF or an entity all of the interests of which are held by a QFPF]." Protecting Americans from Tax Hikes Act of 2015 (the "PATH Act"). However, this language was subsequently modified in 2018's Technical Corrections Act to state that a QFPF and a controlled entity will not be treated as a nonresident alien individual or a foreign corporation for purposes of Code Section 897. Some advisors have argued that this language is equivalent to the "foreign persons" language in the DC-QIE exception.

[6] This is merely an incorporation of the existing statutory rule introduced by the PATH Act in 2015. Code Section 897(h)(4)(E). It seems this would be the case even if the entity is a partnership or other pass-through entity.

[7] This too is a restatement of the PATH Act rule. A RIC or REIT is publicly traded if any class of its stock is regularly traded on an established securities market. In addition, a RIC that issues redeemable securities within the meaning of section 2 of the Investment Company Act of 1940 is also publicly traded. Code Section 897(h)(4)(E)(ii).

[8] A non-publicly-traded REIT or RIC is treated as owned by U.S. persons in proportion to the stock that is (or is treated as) held by U.S. persons. This is required under Code Section 897(h)(4)(E)(iii) and follows from the Proposed Regulations' look-through rule.

[9] The statutory test is whether less than 50% of the value of the stock of the REIT (or RIC) was held "directly or indirectly" by "foreign persons." If this was the case at any time during the testing period (generally 5 years), the entity would not be deemed to be "domestically-controlled" and, the gain on the sale of its shares (as well as the foreign ownership percentage of any distributions by it) would be subject to U.S. taxation. Code Section 897(h). Note that dispositions of interests in DC-QIEs are also subject to special "wash sale" rules.

[10] Treas. Regs. § 1.897-1(c)(2)(i) (referencing Treas. Regs. § 1.857-8(b)).

[11] That being said, the Joint Committee on Taxation has cited this ruling approvingly in the March 2016 Bluebook explaining the 2015 PATH Act, https://www.jct.gov/publications/2016/jcs-1-16/ (text accompanying n.959).

[12] This is the date on which Code Section 897(l) became effective.

[13] The Qualified Holder Rule, which is not found in the 2015 statute, applies with respect to dispositions of United States real property and distributions under Code Section 897(h) occurring on or after June 6, 2019. Final QFPF Regulations Section 1.897(l)-1(g)(2).

[14] However, if an eligible fund is established at the direction of a foreign jurisdiction to provide benefits to the establishing entity's employees in consideration for services rendered to the establishing entity, the final regulations clarify that the fund will be considered an employer fund only.

[15] Although the language of the final regulations is not a model of clarity, the preamble clearly notes that the intent was to allow the provision of limited benefits that fit neither the retirement/pension mold nor the ancillary categories. In effect, a "qualified benefit" now is *any* benefit so long as the QFPF meets the 85% Test and the 5% Limit. The 100% Test appears unnecessary.

[16] Such benefits now include benefits payable upon the diagnosis of a terminal illness, incidental death benefits (for example, funeral expenses), short-term disability benefits, life insurance benefits, and medical benefits, unemployment, shutdown, or layoff benefits that do not continue past retirement age and do not affect the payment of accrued retirement and pension benefits, and other health-related or unemployment benefits that are similar to the benefits described above. For purposes of what benefits are "similar" (and, therefore, also ancillary), the Final QFPF Regulations provide that such similar benefits should also be either health-related or unemployment benefits.