



December 19, 2018

The Honorable Steven T. Mnuchin  
Secretary of the Treasury  
U.S. Department of the Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

The Honorable Charles P. Rettig  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

**RE: Application of Internal Revenue Code Section 897(l) (the Qualified Foreign Pension Fund Exemption from FIRPTA) to Swiss Tax-Exempt Investment Foundations**

Dear Secretary Mnuchin and Commissioner Rettig,

On behalf of *Konferenz der Geschäftsführer von Anlagestiftungen* (“KGAST”) and its affiliated members, we write to respectfully request the issuance of guidance clarifying that foreign tax-exempt investment foundations are entitled to the exemption from United States federal income tax provided by Section 897(l) of the Internal Revenue Code (the “Code”),<sup>1</sup> provided their only beneficial owners are foreign pension funds each of which meets the requirements to be treated as a “qualified foreign pension fund” (a “QFPF”). KGAST is a network of 35 Swiss tax-exempt investment foundations, which, in the aggregate, have over 130 billion Swiss Francs of assets under management. It is one of the leading associations of investment managers of pension fund assets in Switzerland.

A Swiss tax-exempt investment foundation or *Anlagestiftung* (a “Tax-Exempt Investment Foundation”) is a foundation established under Swiss law to manage the retirement assets of Swiss pension funds. Tax-Exempt Investment Foundations are a special category of collective investment vehicles that are governed by the same investment regulations as Swiss pension funds and are subject to regulation by the Occupational Pension Supervisory Commission, an independent Swiss supervisory authority. Tax-Exempt Investment Foundations make investments exclusively on behalf of Swiss pension funds and Swiss pension funds are the only persons permitted to contribute funds to, and hold beneficial interests in, Tax-Exempt Investment Foundations.

As you are aware, on December 18, 2015, the Consolidated Appropriations Act of 2016, which included the Protecting Americans from Tax Hikes Act (the “PATH Act”), was enacted into law.<sup>2</sup> The PATH Act added several new provisions to the Code, including Section 897(l).<sup>3</sup> Generally speaking, Section 897(l) provides QFPFs an exemption from U.S. tax imposed under the Foreign Investment in Real Property Tax Act of 1980 (“FIRPTA”) on the disposition of a “United States real property interest” (a “USRPI”) within the meaning of Section 897(c). Since the enactment of Section 897(l), there has been a noticeable lack of guidance clarifying which foreign entities qualify as QFPFs in addition to what constitutes a QFPF arrangement.

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<sup>1</sup> Unless indicated otherwise, all “Section” or “§” references are references to sections of the Code.

<sup>2</sup> See Pub. L. No. 114-113, 129 Stat. 2242.

<sup>3</sup> See Pub. L. No. 114-113, 129 Stat. 2242, 3102.



Given the broad statutory authority granted the Treasury Department to provide guidance related to Section 897(l),<sup>4</sup> KGAST and its affiliated member Tax-Exempt Investment Foundations believe that the Treasury Department and the Internal Revenue Service have the regulatory authority to issue guidance that addresses the recommendations set forth in this letter. Therefore, as a matter of statutory interpretation, Congressional intent, legislative history, and sound tax policy, we respectfully request that you clarify through guidance that foreign tax-exempt collective investment vehicles such as the Swiss Tax-Exempt Investment Foundations that are members of KGAST are entitled to the exemption from FIRPTA tax provided in Section 897(l), provided all of their beneficial owners qualify as QFPFs.

### **Relevant Statutory Language**

Under FIRPTA, gain or loss from the disposition of a USRPI by a foreign person is subject to U.S. tax as if it were income effectively connected with a U.S. trade or business.<sup>5</sup> USRPIs include direct interests in real property located in the United States, as well as interests in “United States real property holding companies” (“USRPHCs”), which are certain domestic corporations whose assets consist principally of direct or indirect interests in real property.<sup>6</sup> Upon the disposition of a USRPI, including an interest in a USRPHC, the foreign person must pay tax on any net gain at the same rates applicable to U.S. persons.<sup>7</sup>

To provide relief for foreign pension funds seeking real property investments in the United States, Section 897(l)(1) was enacted to provide a general exemption for QFPFs from taxation under FIRPTA. Notably, the language of Section 897(l)(1), as modified by the Tax Cuts and Jobs Act of 2017,<sup>8</sup> extends this general exemption to any “entity all the interests of which are held by a qualified foreign pension fund,” further indicating that such an entity “shall be treated as” a QFPF for purposes of the exemption from taxation under FIRPTA.

Under Section 897(l)(2), a “QFPF” is any trust, corporation, or other organization or arrangement:

- (A) which is created or organized under the law of a country other than the United States;
- (B) which is established to provide retirement or pension benefits to participants or beneficiaries that are current or former employees (or persons designated by such employees) of one or more employers in consideration for services rendered;
- (C) which does not have a single participant or beneficiary with a right to more than five percent of its assets or income;

<sup>4</sup> See § 897(l)(3) (“The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.”).

<sup>5</sup> § 897(a)(1).

<sup>6</sup> §§ 897(c)(1) and 897(c)(2).

<sup>7</sup> See generally §§ 871(b) and 882(a).

<sup>8</sup> Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017). The formal name of the act commonly referred to as the Tax Cuts and Jobs Act is “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.”



- (D) which is subject to government regulation and with respect to which annual information about its beneficiaries is provided, or is otherwise available, to the relevant tax authorities in the country in which it is established or operates; and
- (E) with respect to which, under the laws of the country in which it is established or operates
  - (i) contributions to such trust, corporation, organization, or arrangement which would otherwise be subject to tax under such laws are deductible or excluded from the gross income of such entity or arrangement or taxed at a reduced rate, or
  - (ii) taxation of any investment income of such trust, corporation, organization or arrangement is deferred, or such income is excluded from the gross income of such entity or arrangement or is taxed at a reduced rate.

Accordingly, entities that meet the definition of a QFPF under Section 897(l)(2) and entities that are wholly owned by QFPFs should be able to dispose of USRPIs, including interests in USRPHCs, without triggering FIRPTA tax.

#### **Swiss Tax-Exempt Investments Foundations Should be Exempt from FIRPTA Tax**

As previously referenced, Swiss Tax-Exempt Investment Foundations are tax-exempt collective investment vehicles that are specifically and exclusively designed for Swiss pensions. Swiss Tax-Exempt Investment Foundations are particularly attractive for small- and medium-sized Swiss pension funds that do not have sufficient assets to achieve efficient diversification through direct investments. Consequently, Tax-Exempt Investment Foundations are utilized by Swiss pension funds to ensure portfolio diversification. Since a Tax-Exempt Investment Foundation aggregates the assets of various Swiss pension funds, it is able to effect a broad array of investments, which may include investments in USRPIs, including investments in USRPHCs. As discussed below, tax-exempt collective investment vehicles such as the Swiss Tax-Exempt Investment Foundations that are members of KGAST should be entitled to the exemption from FIRPTA tax provided in Section 897(l). This is because Section 897(l), as currently enacted, should not be interpreted to deny a QFPF an exemption from tax under FIRPTA because the QFPF structures its investments through an aggregator investment vehicle of which it and other QFPFs are the sole beneficial owners.

The extension of the general FIRPTA exemption under Section 897(l)(1) to entities that are wholly-owned by a QFPF was added in recognition of the fact that a QFPF might not invest in a USRPI directly, but through a wholly-owned subsidiary such as a Tax-Exempt Investment Foundation. Unfortunately, however, it is not clear whether such a subsidiary entity must be wholly-owned by only one QFPF, or whether it can be wholly-owned by multiple QFPFs, in order to qualify for the exemption. Technically, the language of Section 897(l)(1) provides that the exemption applies to an entity “all of the interests of which are held by a qualified foreign pension fund.”<sup>9</sup> Therefore, it could be argued that a literal reading of this language seems to exclude an entity that is wholly owned by multiple QFPFs. However, there is no rationale or logic for excluding an entity all of the beneficial interests in which are held by QFPFs, whether those beneficial interests are held by only one QFPF or multiple QFPFs.

Congress circumscribed a specific definition of a QFPF, and then provided a wholesale exemption from taxation under FIRPTA for the narrow class of persons that fall within the specific definition. It would be contrary to such intent to deny a QFPF an exemption from tax under FIRPTA for investments in USRPIs merely because the QFPF structured such investments along with other QFPFs using an aggregator investment vehicle. Often times, QFPFs

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<sup>9</sup> Emphasis added.



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from a foreign country are required to make investments in such a manner alongside other QFPFs from the same country pursuant to particular legal or investment guidelines. Moreover, given the fact that many QFPFs do not individually possess sufficient assets to achieve portfolio diversification through direct investments in USRPIs, aggregating and structuring such investments along with other QFPFs (of a similar size) gives many small- and medium-sized QFPFs access to meaningful investment opportunities in real property assets in the United States that would not otherwise be available. In fact, increased access to, and the promotion of, investment in the United States was the goal that served as the genesis for Section 897(I). According to reports, when the prior administration learned that “foreign pension funds” would invest in U.S. infrastructure but for the FIRPTA tax,<sup>10</sup> it was suggested that foreign pension funds should be exempt from U.S. tax to the same extent that U.S. pension funds are.<sup>11</sup> Improving access to capital aimed at rebuilding the United States’ aging infrastructure is also one of the major stated policy goals of the current administration.<sup>12</sup> Accordingly, Section 897(I) should be construed broadly in a manner that would increase access to, and promote investment in, the United States, and therefore, the Treasury Department and the Internal Revenue Service should confirm that entities such as Swiss Tax-Exempt Investment Foundations, all of the beneficial interests in which are held by multiple QFPFs, are entitled to the exemption from taxation under FIRPTA provided in Section 897(I).

#### **Requested Guidance under Section 897(I)**

We appreciate your consideration of our request detailed above. As a general matter, it is our view that the Treasury Department and the Internal Revenue Service should issue proposed, temporary, or final regulations that provide clarity with respect to qualification as a QFPF under Section 897(I). Specifically, we request that the Treasury Department and the Internal Revenue Service issue guidance under the broad grant of statutory authority granted to them by Section 897(I) to clarify that a foreign tax-exempt collective investment vehicle, such as a Swiss Tax-Exempt Investment Foundation, qualifies as an “entity” that is entitled to the exemption from taxation under FIRPTA provided in Section 897(I), if all of the beneficial owners of such an investment vehicle are themselves QFPFs. Neither the best reading of the statute, Congressional intent, legislative history, nor sound tax policy would justify denying an entity such as a Tax-Exempt Investment Foundation the exemption from FIRPTA tax merely because it makes investments in USRPIs or USRPHCs specifically and exclusively on behalf of QFPFs. Until such clarification is issued, tax-exempt foreign collective investment vehicles will be less likely to invest in United States real property due to potential exposure to taxation under FIRPTA, which, in turn, will limit access for many small- and medium-sized foreign pension funds seeking investment opportunities in the United States.

We thank you for your consideration of our comments on Section 897(I). We would be more than happy to answer any questions you may have about any of the issues we have raised above.

Sincerely,

Markus Anliker

Roland Kriemler

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<sup>10</sup> Although the contours of the definition remain unclear, most infrastructure assets likely qualify as USRPIs. See Announcement 2008-115, 2008-48 I.R.B. 1228.

<sup>11</sup> *Obama Pushes Plan to Build Roads and Bridges*, New York Times (Mar. 29, 2013).

<sup>12</sup> *Trump Unveils Infrastructure Plan; Uphill Battle Awaits in Congress*, Reuters (Feb. 12, 2018).



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