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INTERNAL REVENUE SERVICE NATIONAL OFFICE SIGNIFICANT SERVICE  
CENTER ADVICE

MEMORANDUM FOR Felecia Davenport  
Program Analyst S:CAS:B:P

FROM: M. Grace Fleeman  
Assistant to the Branch Chief CC:INTL:BR1

SUBJECT: Treaty Certification of Common Trust Funds

This Significant Service Center Advice responds to your request for advice concerning the treaty certification of common trust funds, as defined in section 584(a).<sup>1</sup> This document is not to be used or cited as precedent.

ISSUE

Whether the Philadelphia Service Center ("PSC") should certify the residency of a common trust fund for treaty purposes at the entity level or the participant level.

CONCLUSION

Because a common trust fund is not itself "liable to tax," and it is possible that one or more of the participants in the common trust fund might not be a resident of the United States, it is necessary for the PSC to certify residency at the participant level. Thus, the PSC should certify that the fund files a Form 1065 or other return as a U.S. common trust fund and that either (1) each participant listed on the Form 1065 or other return is a resident of the United States for U.S. tax purposes, or (2) those participants named on an attached list are residents of the United States for U.S. tax purposes. Note that if the common trust fund can qualify as a group trust described in Revenue Ruling 81-100 that has received a determination letter

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<sup>1</sup> Unless otherwise indicated, all references to "section" are to sections of the Internal Revenue Code ("Code").

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recognizing its exempt status under section 501(a) of the Code, the PSC may be able to certify that the fund is a group trust arrangement described in Revenue Ruling 81-100 and that each participant is a resident of the United States.

## FACTS

Most foreign jurisdictions withhold tax at a statutory rate on certain types of income paid from sources within their jurisdictions to residents of other jurisdictions. In many cases, however, the United States has entered into an income tax treaty with that jurisdiction that may reduce the statutory tax rate for income paid to U.S. residents. In order to obtain the treaty-reduced rate, U.S. residents are generally required to provide proof of residency.

As proof of U.S. residency, foreign jurisdictions often require the U.S. government to certify that an applicant for treaty benefits files a tax return as a U.S. resident. U.S. taxpayers may request such certification from the PSC. If the applicant is an individual citizen or resident of the United States, a domestic corporation, a domestic trust, or a domestic estate, the PSC issues a computer-generated letter (Form 6166) to the applicant to certify that the applicant is a resident of the United States for treaty purposes based on the applicant's filing status in the United States as a resident. If the applicant is a partnership, the PSC issues a Form 6166 certifying that the partnership has filed a Form 1065 and that either (1) each partner listed on the Form 1065 is a resident of the United States for purposes of U.S. tax purposes, or (2) those partners named on an attached list are residents of the United States for U.S. tax purposes.

Because a common trust fund is a pass-through entity for U.S. tax purposes, a number of questions have arisen concerning the certification of common trust funds and their participants, particularly in the context of funds holding the assets of tax-exempt pension plans.

## LAW AND ANALYSIS

### Common Trust Funds

Section 584(a) defines the term "common trust fund" as

a fund maintained by a bank – (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity – (A) as a trustee, executor, administrator, or guardian, or (B) as a custodian of accounts . . . and (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System or the Comptroller

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of the Currency pertaining to the collective investment of trust funds by national banks.

Treasury Regulation §1.584-1(b) provides that in order

[f]or a fund to be qualified as a common trust fund it must be maintained by a bank (as defined in section 581) in conformity with the rules and regulations of the Comptroller of the Currency, exclusively for the collective investment and reinvestment of contributions to the fund by the bank.

The regulations of the Comptroller of the Currency provide that a national bank may invest assets that it holds as a fiduciary in two different types of collective investment funds:

(1) A fund maintained by the bank, or by one or more affiliated banks, exclusively for the collective investment and reinvestment of money contributed to the fund by the bank, or by one or more affiliated banks, in its capacity as trustee, executor, administrator, guardian, or custodian under a uniform gifts to minors act.

(2) A fund consisting solely of assets of retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income tax.

12 C.F.R. §9.18(a) (footnote omitted). Both types of collective investment funds may qualify as a common trust fund under section 584.

Section 584(b) provides that a common trust fund shall not be subject to taxation under this chapter [i.e., Chapter 1 (Normal Taxes and Surtaxes)] and for purposes of this chapter shall not be considered a corporation. However, pursuant to section 584(c), each participant in a common trust fund in computing its taxable income must include, whether or not distributed and whether or not distributable –

(1) as part of its gains and losses from sales or exchanges of capital assets held for not more than 1 year, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for not more than 1 year,

(2) as part of its gains and losses from sales or exchanges of capital assets held for more than 1 year, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than 1 year, and

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(3) its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in subsection (d).

Thus, a common trust fund is not taxable on its income. Rather, income, gains, and losses flow through to the participants in the fund, and are included in the income of the participants, whether or not such income is actually distributed. The character and source of any item of income or gain earned by a common trust fund retains the same character and source and flows through from the fund to the participants in the fund on a pro rata basis.

Every bank that maintains a common trust fund is required to file an annual return including, *inter alia*, the names and addresses of the participants who would be entitled to share in the taxable income if it were distributed. Code §6032. No particular form is prescribed for making the return, but it may be on a Form 1065. Treas. Reg. §1.6032-1.

#### “Liable to Tax” Standard

Under the bilateral income tax treaties to which the United States is a party, a “resident” of the United States is defined in terms of a person who is “liable to tax” under the laws of the United States by reason of certain criteria. A typical provision is found in Article 4, paragraph 1 of the 1996 U.S. model income tax treaty, which provides, in pertinent part, that:

[e]xcept as provided in this paragraph, for the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature.

When determining whether a domestic entity should be certified as a resident of the United States, it is first necessary to consider whether the entity will be considered “liable to tax” in the United States for treaty purposes.

In Rev. Rul. 2000-59, 2000-52 I.R.B. 593, the Service issued guidance on whether certain foreign persons are considered liable to tax by reason of their domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature for purposes of determining whether such persons are residents of a foreign jurisdiction within the meaning of the relevant treaty. Revenue Ruling 2000-59 provides that whether a person is liable to tax in, and thus a resident of, a treaty jurisdiction depends on the facts and circumstances. In each of the three situations described in the revenue ruling, the person was liable to tax

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in the foreign jurisdiction in which it was organized at the entity level on its worldwide income, but either the person was allowed to eliminate its taxable income through distribution deductions or the income received by the person was exempt from tax based on a special tax regime applicable to that person (investment company or pension trust). Nonetheless, the persons were considered liable to tax because they were entities that would have been taxed in that jurisdiction on their worldwide income but for the special regime, and the character and the sources of the distributions made by those entities were determined independently of the character and the source of the entities' underlying income.

The same principles apply to determine whether a person is considered liable to tax in the United States for purposes of determining whether the person is a resident of the United States for treaty purposes.

#### Certification of Common Trust Funds

Based on the principles described above, a common trust fund is not considered a person "liable to tax" within the meaning of the residence article of U.S. income tax treaties. Although a common trust fund is established in the United States, it is not taxable by the United States, at the entity level, on its worldwide income. Code §584(b). In addition, the character and source of the income distributed to common trust fund participants are not determined independently of the character and source of such income in the hands of the common trust fund. Code §584(c). Thus, a common trust fund is not liable to tax under the principles of Revenue Ruling 2000-59 and cannot be treated as a resident of the United States that is entitled to benefits under our income tax treaties. However, the participants in the common trust fund may be liable to tax under the principles of Revenue Ruling 2000-59, even if they are pension funds or other organizations that are exempt from tax based on a special tax regime.

The PSC should certify a common trust fund in the same manner that it certifies a partnership. Thus, the PSC should certify that the fund files a Form 1065 or other return as a U.S. common trust fund and that either (1) each participant listed on the Form 1065 or other return is a resident of the United States for U.S. tax purposes or (2) those participants named on an attached list are residents of the United States for U.S. tax purposes.

It has been suggested that in the case of a common trust fund described in 12 C.F.R. §9.18(a)(2), where the only investors are retirement, pension, profit sharing, stock bonus or other trusts that are exempt from Federal income taxation, it should not be necessary to look at the participants, because each participant would necessarily be entitled to treaty benefits. This argument overlooks the fact that some trusts that are exempt from Federal income taxation may be foreign trusts that

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could never qualify as residents of the United States for treaty purposes. For example, a trust that is exempt from Federal income taxation under section 501(c)(3) may be a foreign trust. Consequently, it would not be appropriate to certify a common trust fund described in 12 C.F.R. §9.18(a)(2) at the entity level.

However, if the only participants in a common trust fund are trusts forming parts of qualified retirement plans and individual retirement accounts (which trusts are required by statute to be created or organized in the United States), the common trust fund may qualify as a group trust under Rev. Rul. 81-100, 1981-1 C.B. 326. If such a fund has obtained a determination letter recognizing that it is exempt from Federal income tax under section 501(a), it would be appropriate for the PSC to certify that the fund is a group trust arrangement described in Revenue Ruling 81-100, and that each participant is a resident of the United States.

If you have any further questions, please call (202) 622-3880.

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