

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Deputy Division Counsel LMSB (Technical)

from: Associate Chief Counsel (International)

subject: Foreign government pension trusts

This memorandum addresses the trustee requirement of Temp. Treas. Reg. §1.892-2T(c)(1)(ii). This advice may not be used or cited as precedent.

ISSUE

Whether the requirement of Temp. Treas. Reg. §1.892-2T(c)(1)(ii) that the funds that comprise a foreign government pension trust must be managed by trustees who are employees of, or persons appointed by, the foreign government is satisfied if a majority of trustees, rather than all the trustees, are such individuals.

CONCLUSION

The trustee requirement of Temp. Treas. Reg. §1.892-2T(c)(1)(ii) is satisfied if (1) as a matter of organization, the majority of trustees of the trust are either government employees or persons appointed by the foreign government, and (2) as a matter of operation, all substantial actions of the trust are approved by a majority of the trustees that are either government employees or persons appointed by the government.

PRESUMED FACTS

Pursuant to legislation ("Act"), a foreign country ("Country X") authorized the establishment of a pension plan ("Pension Plan") to provide pension benefits to current and former members of a Country X non-government body ("Organization") and their dependents and beneficiaries. Membership in Organization is reserved exclusively to (i) current and former employees of Country X and (ii) current and former non-Country X

employees that perform or performed public or social service functions (“Pension Plan members”).

Pursuant to an agreement (“Agreement”), Country X and Organization established a separately organized pension trust (“Trust”) to hold and invest the assets of Pension Plan to provide pension benefits to Pension Plan members. Trust is an entity separate and distinct from Country X and Organization that invests in public and private equity and fixed income markets of Country X and other countries, including the United States.

The terms of the Agreement between Country X and Organization provides for the establishment of a joint board of trustees (“Board”) to administer Pension Plan and invest and manage the assets of Trust. The operation and administration of Trust, including custody, investment, and management of Trust, are the sole responsibility of the Board. The Board is comprised of eight trustees. Country X and Organization each appoint half of those trustees (Country X Trustees and Organization Trustees, respectively). Under the Agreement, at least two of the Organization Trustees must be employees of Country X government. Any resolution of the Board requires support of the majority of the trustees present, provided that there is a quorum of five trustees and that at least one Country X Trustee and one Organization Trustee supports the resolution. In the case of a deadlock, the Agreement provides that an additional trustee is to be appointed by mutual agreement between Country X and Organization. If they cannot agree, the terms of the Agreement provide a mechanism for the appointment of the additional trustee.

LAW AND ANALYSIS

Section 892(a)(1) of the Internal Revenue Code excludes from gross income and exempts from U.S. federal income taxation certain income of foreign governments. Such excluded income includes only income received from investments in the United States in stocks, bonds, or other domestic securities owned by such foreign governments; income received from financial instruments held in the execution of governmental financial or monetary policy; and interest on deposits in banks in the United States of monies belonging to such foreign governments. The exclusion does not apply to income derived from the conduct of any commercial activity, whether within or without the United States, or to income received directly or indirectly from or by a controlled commercial entity or derived from the disposition of any interest in a controlled entity. Section 892(a)(2)(A) of the Code.

For purposes of section 892 of the Code, the term "foreign government" means only the integral parts or controlled entities of a foreign sovereign. Temp. Treas. Reg. ' 1.892-2T(a)(1). Temp. Treas. Reg. ' 1.892-2T(d) provides that the rules that apply to a foreign sovereign apply to political subdivisions of a foreign country. A "controlled entity" is an entity that is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity provided that: (i) it is wholly owned and controlled by the foreign sovereign, directly or indirectly, through one or more controlled entities; (ii) it is

organized under the laws of the foreign sovereign by which it is owned; (iii) its net earnings are credited to its own account or to other accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and (iv) its assets vest in the foreign sovereign upon dissolution. Temp. Treas. Reg. ' 1.892-2T(a)(3).

Temp. Treas. Reg. ' 1.892-2T(c)(1) provides that a "controlled entity" includes a separately organized pension trust that meets the following requirements:

- (i) The trust is established exclusively for the benefit of (A) employees or former employees of a foreign government or (B) employees or former employees of a foreign government and non-governmental employees or former employees that perform or performed governmental or social services;
- (ii) The funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government;
- (iii) The trust forming a part of Pension Plan provides for retirement, disability, or death benefits in consideration for prior services rendered; and
- (iv) Income of the trust satisfies the obligations of the foreign government to participants under the plan, rather than inuring to the benefit of a private person.

The pension trust provision of Temp. Treas. Reg. §1.892-2T(c) is a limited exception that permits a trust, which is not a controlled entity within the meaning of Temp. Treas. Reg. § 1.892-2T(a)(3), to be treated as a "controlled entity" for purposes of section 892 if the trust complies with all four of the listed requirements.

In our opinion, the trustee requirement of Temp. Treas. Reg. §1.892-2T(c)(1)(ii) is satisfied if (1) as a matter of organization, the majority of trustees of the trust are either government employees or persons appointed by the foreign government, and (2) as a matter of operation, all substantial actions of the trust are approved by a majority of the trustees that are either government employees or persons appointed by the government. Under the presumed set of facts, the matter of organization is met because a majority of trustees of the Board are required to be Country X government employees. The matter of operation will be met if, in actual operation, all substantial actions of the Trust have been approved by a majority of trustees of the Board that are either government employees or persons appointed by the government.