April 15, 2015

To: US Senate International Tax Reform Working Group
Senator Charles Schumer, Co-Chair
Senator Rob Portman, Co-Chair
Senator Michael Enzi
Senator Pat Roberts
Senator John Cornyn
Senator Thomas Carper
Senator Sherrod Brown
Senator Mark Warner
International@finance.senate.gov

Dear Senators,

Re: Reform of the Foreign Investment in Real Property Tax Act (FIRPTA)

The Canada Pension Plan Investment Board (CPPIB) and the Ontario Teachers' Pension Plan (Teachers') appreciate the opportunity to share our views regarding proposed changes to the *Foreign Investment in Real Property Tax Act* (FIRPTA).

We applaud the efforts of the Senate Finance Committee and the international tax reform working group to modernize the US tax code. As part of your efforts, we strongly encourage the working group to consider reforming FIRPTA, which we believe will lead to stable, long-term pension investments in areas that are critical to the economy in the US.

We appreciate the opportunity to explain our support for FIRPTA reform, and how it currently inhibits significant investments from foreign pension funds in US real estate and infrastructure assets.

FIRPTA: An Impediment to Investment

FIRPTA is a unique US capital gains tax (35%) imposed on non-residents from the sale of US real property. Under current law, gains of non-resident investors from the disposition of US real property interests are generally subject to US tax under FIRPTA, and non-resident investors including large foreign pension funds – such as CPPIB and Teachers' – cite FIRPTA as a particularly punitive impediment to their investment in US infrastructure, real estate and other assets.

FIRPTA acts as a significant barrier to foreign investment in US infrastructure and real estate at a time when the estimated value of the US commercial real estate industry is below its pre-financial crisis

peak,[1] and when the United States is in dire need of approximately $3.6 trillion of infrastructure funding by 2020.[2]

Reform of FIRPTA would help unlock capital that could be put to work in the US. With US pension funds generally exempt from US tax upon the disposition of US real property investments, long-term investors like CPPIB and Teachers' welcome the various Senate, Congressional and Administrative initiatives to widen sources of scarce long-term capital by putting foreign pension funds on an approximately equal footing: exempting their gains from the disposition of US real property interests from US tax under FIRPTA, putting them on the same level as USA domestic pension plans.

Why the US Needs FIRPTA Reform

Foreign direct investment (FDI) benefits US workers and companies by creating jobs and providing vital resources to spur economic development and growth.

In 2014, FDI in the United States totaled approximately $98 billion, down from $236 billion in 2013. This is a decrease of 60% year-to-year, and represents the lowest level of FDI in the US in a decade. The United States' share of FDI has dropped to 7% from 35% in 2000, falling behind China and Hong Kong.[3] Further, America faces severe budgetary challenges, with a $468 billion federal budget deficit and roughly $13.1 trillion in long-term public debt.[4] Its fiscal situation has inhibited the US federal government from investing to address the country's national infrastructure needs.

While investing in infrastructure and addressing the US's fiscal problems require long-term solutions, there are ways to assist those efforts and invest now using available foreign capital. FIRPTA reform will help drive available capital from foreign pension funds and other investors towards the US, to help achieve the goals for real estate development and infrastructure investment set out by the federal government. The US market will benefit in both the short and long term, as it will continue to face increased competition for investment from foreign sources. GDP growth in emerging markets is expected to climb in the years ahead, driving investors to increase focus on opportunities in those countries.

Competition for Investment Capital is Global

Like other global investment organizations, pension plans such as CPPIB and Teachers' review and compare opportunities around the world, not just within particular countries or regions. In effect, each investment opportunity must compete for our capital on a global basis.

[1] CRE Group Back Proposal to Grant FIRPTA Exemptions to Foreign Pension Investors, Randyl Drummer, Co-Star Group, April 3, 2013.
[2] Report Card for American Infrastructure, American Society of Civil Engineers (ASCE), 2013.
3 Foreign Direct Investment in the United States: 2014 Preliminary Data, Organization for International Investment (OFII), March 19, 2015.
4 The Budget and Economic Outlook: 2015 to 2025, Congressional Budget Office (CBO), January 26, 2015

Our collective investments to date in the US of CAD$134.9 billion (CPPIB $88.1 billion, Teachers' $46.8 billion) reflect our long-term confidence in the US and its economy. These investments are predominantly spread across public and private equities, real estate and debt. As last reported, our collective global infrastructure and real estate portfolios amount to a total of CAD$74.2 billion (CPPIB $39.5 billion, Teachers' $34.7 billion). Of this amount, only 3% is US infrastructure, meaning that less than 1.6% of our US investments are in US infrastructure.

CPPIB and Teachers' both focus our efforts on jurisdictions that are open to foreign direct investment, and treat international investors fairly. We also compare jurisdictions and focus on those that will allow us to provide the best risk/return solution to our respective contributors and beneficiaries.

Filling the Funding Gap for Real Estate Development Capital
Contributing to US Competiveness Globally

Real estate is a capital-intensive business. This is most evident during the development stage of a property's life cycle, where often debt financing is unavailable and local developers lack the financial resources to fully fund these projects independently. Large foreign pension plans can provide the necessary partnership capital and play a large role in spurring job growth in the US development and construction industries. However, FIRPTA impedes foreign pension funds' ability to fully bridge this funding gap. New construction and development in the commercial real estate sector can also contribute to US global competitiveness. Such an example can be found in the US industrial and multi-family residential sectors. New modern logistics facilities streamline the supply-chain management process, similar to improvements in transportation infrastructure. Investment in the multifamily residential sector promotes urbanization and densification, which can alleviate the strain on existing highway infrastructure as a result of urban sprawl, spur employment in the construction sector, and provide jobs to the middle class.

Over-Inclusiveness of Definition of "Real Property"

As an example of why FIRPTA needs general reform, there is arguably an over-inclusiveness of the definition of 'real property'. FIRPTA applies not only to traditional real estate investments — such as office buildings or residential development — but also to commercial and industrial operating businesses that happen to require significant real property in their operations. This is because "real property" has been defined to include buildings, fixtures (including machinery that has been "affixed" to buildings or land), mineral rights, certain permits and easements, and can also apply to investments in corporate stock and partnership interests.

Leveling the Playing Field

FIRPTA acts as a significant financial deterrent for foreign pension funds, who as fiduciaries evaluate investments on a risk-return basis. This places foreign pension plans on an uneven playing field with other foreign investors, such as certain sovereign wealth funds, who may have political or other non-

economic motivations to invest in the US. In those cases, FIRPTA would not likely provide a deterrent. FIRPTA in fact handicaps foreign pension funds in providing a competitive price for US assets and thus reduces the available pool of capital to compete for US assets. FIRPTA clearly places foreign pension plans at a competitive disadvantage to analogous domestic entities. Domestic pension plans and state governments and agencies are generally exempt from US tax on such gains. Further, US and state governmental organizations and certain of their pension plans and educational institutions (like the California Public Employees' Retirement System) are completely exempt from US tax, even on the operating income of active businesses, creating an even greater disparity.

Attracting Long-Horizon Investors

Foreign pension funds – like CPPIB and Teachers' – are an attractive partner as governments and organizations around the world that seek much needed long-term capital. Given our long investment horizon, we can be patient investors. We have the ability to hold these assets for extended periods of time so that we are able to realize the returns of the assets. An exceptionally lengthy investment horizon shapes our perspective on opportunities. We invest for the next quarter century, not the next quarter. Accordingly, we can assess and pursue opportunities differently and stay the course when many cannot.

Further, our long-term perspective makes patient capital available for commitments that can create value for many years to come. During the holding period of assets we can provide careful stewardship, enhanced governance, and improvements in assets, operations and profitability. We are well-positioned to be a beneficial owner of infrastructure and real estate assets. In particular, our approach to investing, our ability to invest throughout the economic cycle, our willingness to invest additional follow-on capital to foster growth and expansion, and our position as the professional investment organization for a national pension plan can make us preferred owners of privatized infrastructure assets.

Translating Good Policy to Legislation

FIPRTA reform can help spur economic development and long-term growth in the US. For all of these reasons outlined above, we believe **providing a FIRPTA exemption to foreign pension plans** represents good policy to stimulate investment in US infrastructure and real estate sectors.

For example, in 2014 CPPIB and Teachers' provided suggested legislative language in respect of former Senate Chairman Baucus' proposed changes to the *Foreign Investment in Real Property Act* (FIRPTA) in the International Tax Reform Discussion Draft.

In the Baucus example, many foreign pension plans, including the Canada Pension Plan and CPPIB, did not meet the discussion draft's definition of "qualified foreign pension fund" without significant regulatory relief from the literal terms of the existing language. The Baucus definition borrowed heavily from the definition of "retirement funds" in the recently finalized *Foreign Account Tax Compliance* Act

(FATCA) regulations, but we noted that it included only a narrow subset of the types of "retirement funds" that are exempt under the FATCA regulations. The FATCA regulations had a similarly narrow definition when those regulations were in proposed form, but the definition was expanded in acknowledgement that similarly situated foreign pension plans would not meet the originally proposed narrow definition. We suggested to former Chairman Baucus that, at a minimum, the definition of "qualified foreign pension fund" should be expanded more clearly to include treaty-qualified funds and investment vehicles established exclusively to earn income for the benefit of one or more retirement funds (as defined), both of which are included in the definition of "retirement funds" under the FATCA regulations. Arguably, there is no reason to differentiate between an investment vehicle wholly owned by a pension plan and an investment vehicle that is not actually owned by the pension fund, but which exclusively earns income for the exclusive benefit of the pension plan.

Second, it was clarified that if a pension plan provides death or disability benefits as well as conventional retirement or pension benefits, it should not be excluded from the definition of "foreign pension plan". Many "pension plans" currently provide those benefits. The proposed Baucus language left it unclear whether a pension plan can provide such benefits and still qualify for the FIRPTA exemption. Similarly, some pension plans — like the Canada Pension Plan for which CPPIB was established — provide pension benefits to self-employed Canadians (as well as employees). We can see no reason consistent with the purpose of the exemption for excluding pension plans that provide pensions to the self-employed as well as employees.

Finally, the purpose and scope of information reporting required by proposed Section 897(k)(2)(D) was not clear. We agreed that an information reporting provision is sensible in the context of a regime, such as FATCA, designed to induce transparency in foreign accounts held by US taxpayers. Reporting requirements, however, serve no real purpose in the context of FIRPTA, where the definition is used to distinguish pension funds from other investment vehicles. We believe that FATCA is the place for such requirements, and, if a foreign pension plan meets its obligations under FATCA, no additional information reporting obligations should be relevant or necessary under FIRPTA.

To address the drafting concerns we noted, we had recommended to former Chairman Baucus discrete suggestions on how to refine the proposed legislation to ensure significant foreign pension plans are not excluded from the proposed FIRPTA exemption. (See Appendix 2)

We include this suggested legislative language as a potential starting point for the International Tax Reform Working Group as it considers potential legislative FIRPTA reforms.

In conclusion, we deeply appreciate the efforts in the International Tax Reform Working Group to reform and update the US tax code, and hope that the working group will consider amending FIRPTA to encourage stable, long-term foreign pension investments in the US. We would be happy to make our pension funds available to the Working Group to assist in any way possible.

Sincerely,





Mark D. Wiseman
President & Chief Executive Officer
Canada Pension Plan Investment Board

Ron Mock
President and Chief Executive Officer
Ontario Teachers' Pension Plan

Attachments (2):
Appendix 1: About CPPIB and Teachers'
Appendix 2: Proposed Amendments to the Foreign Investment in Real Property Act (FIRPTA)

APPENDIX 1
ABOUT CPPIB & TEACHERS'

The Canada Pension Plan Investment Board (CPPIB) and the Ontario Teachers' Pension Plan (Teachers') are **two distinct Canadian pension funds** that **invest strictly on a risk-return basis**, with professional and independent governance structures, **free from political or government influence**.

CPPIB and Teachers' are **long-term, patient providers of capital**. Unlike many investors, because of their respective size, scale and certainty of assets, they are able to make very large placements in large infrastructure and real estate investments, have the ability to hold those assets literally for decades, and importantly, have the ability to provide follow-on capital to keep assets refreshed throughout the life-cycle of the asset.

CPPIB and Teachers' **do not have geographic allocations**, but rather invest globally comparing investment opportunities based on markets that are inherently open to foreign capital, have stable and transparent regulatory environments, and provide a level playing field for all investors.

(1) CANADA PENSION PLAN INVESTMENT BOARD (CPPIB)

Canada Pension Plan Investment Board (CPPIB) is a global professional investment management organization that invests the funds not needed by the Canada Pension Plan (CPP) to pay current benefits on behalf of 18 million Canadian contributors and beneficiaries. In order to build a diversified portfolio of CPP assets, CPPIB invests in public equities, private equities, real estate, infrastructure and fixed income instruments. Headquartered in Toronto, with offices in **New York**, London, Hong Kong, and Sao Paulo.

At December 31, 2014, the **CPP Fund totaled $238.8 billion, making it Canada's largest single-purpose pension fund and ranking among the 10 largest retirement funds in the world today. CPPIB's assets are projected to reach $275 billion by 2020 and more than $1 trillion by 2050**. **During fiscal 2014, CPPIB completed 45 deals in 11 countries around the world worth more than $200 million each**.

CPPIB has a **significant investment portfolio in the United States, with over $88.1 billion (36.9% of CPPIB's total assets)** invested in equity and fixed income holdings in many public and private companies, ownership interests in significant real estate developments and commitments to numerous real estate and private equity funds.

CPPIB's comparative advantages – including our long investment horizon, certainty of assets, size and scale – make CPPIB an important provider of capital for long-term projects and allow us to shape investments, not just respond to them. CPPIB is governed and managed independently of the CPP and at arm's length from governments. CPP Fund assets are not direct government assets and are not

dependent on tax revenues. The assets CPPIB manages belong to the 18 million Canadian contributors and beneficiaries who participate in the CPP and are strictly segregated from and not included as part of government funds. CPPIB's arm's length governance system, including its investment-only mandate and independent board of highly qualified professional directors, is a globally recognized model for pension plans.

(2) **ONTARIO TEACHERS' PENSION PLAN (TEACHERS')**

Teachers' is Canada's largest single-profession pension plan with $154.5 billion in net assets as of December 31, 2014. An independent organization, it invests the pension fund's assets and administer the pensions of 311,000 active and retired teachers in Ontario. Since our establishment as an independent organization in 1990, we have built an international reputation for innovation and leadership in investment management and member services. Teachers' investment program has one goal: to earn the best possible returns, at an appropriate level of risk, to pay pensions to our members. Teachers' has approximately 1,000 employees. Our head office is in Toronto, Canada, and we also operate regional investment offices in London, England and in Hong Kong and have an office in **New York.** More than 1,400 people work at our real estate subsidiary, Cadillac Fairview.

Teachers' has over **$46.8 billion invested in the United States** in various asset classes including public and private equity, fixed income, real estate and infrastructure.

APPENDIX 2
PROPOSED AMENDMENTS TO THE FOREIGN INVESTMENT IN REAL PROPERTY ACT (FIRPTA)

"(k) EXCEPTION FOR INTERESTS HELD BY FOREIGN PENSION FUNDS.—

"(1) IN GENERAL.—This section shall not apply to any United States real property interest held by—

"(A) a qualified foreign pension fund, ~~or~~

"(B) any other entity wholly owned by a qualified foreign pension fund~~.~~, or

"(C) a trust, corporation, or other organization or arrangement established exclusively to earn income for the benefit of one or more qualified foreign pension funds or entities wholly owned by such a trust, corporation or other organization or arrangement.

Comment [CPPIB/OTP1]: This is from FATCA. Regs § 1.1471-6(f)(5).

"(2) QUALIFIED FOREIGN PENSION FUND.—For purposes of this subsection, the term 'qualified foreign pension fund' means any trust, corporation, or other organization or arrangement—

"(A) which is created or organized outside of the United States, and either--

"(B) ~~which~~(i) is established to provide or administer retirement~~or~~, pension-, or similar benefits to participants or beneficiaries that either are current or former employees (or persons designated by such employees) of one or more employers in consideration for ~~services rendered,~~ services rendered or are (or were) self-employed persons (or persons designated by such persons) who have made contributions in respect of such benefits ,

Comment [CPPIB/OTP2]: To cover fact that pension funds often administer pension plans as well as provided benefits to retirees. Similar to US-Canada treaty provisions.

Comment [CPPIB/OTP3]: To pick up provision of disability and death benefits

Comment [CPPIB/OTP4]: Added to deal with the fact that some governmental and other plans cover the self-employed as well.

"~~(C) which~~ii) does not have a single participant or beneficiary with a right to more than five percent of its assets,

"~~(D) which~~iii) is subject to government regulation ~~and provides annual information reporting about its beneficiaries to the relevant tax authorities~~ in the country in which it is established or operates, and

"~~(E~~iv) with respect to ~~which~~such trust, corporation, or other organization or arrangement, under the laws of the country in which it is established or operates—

Comment [CPPIB/OTP5]: Deleted language is from FATCA and is not relevant in this context.

Comment [CPPIB/OTP6]: Required grammatical change

"(ii) 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 taxed at a reduced rate, or

"(iii) taxation of any investment income of such trust, corporation, organization, or arrangement is deferred or such income is taxed at a reduced rate or is tax exempt; or

"(C) is established in a country with which the United States has an income tax treaty in force, provided that such trust, corporation or other organization or arrangement is entitled to benefits under such treaty on income that it derives from sources within the United States (or would be entitled to such benefits if it derived any such income) as a resident of the other country that satisfies any applicable limitation on benefits requirement, and is operated principally to administer or provide pension or retirement benefits.

"(3) REGULATIONS.—The Secretary may prescribe such regulations as are necessary to carry out the purposes of this subsection."

(2) EXEMPTION FROM WITHHOLDING.—

(A) IN GENERAL.—Section 1445(b) is amended by adding at the end the following:

"(10) DISPOSITIONS BY QUALIFIED FOREIGN PENSION FUNDS.—This paragraph applies to any disposition of any United States real property interest by a qualified foreign pension fund (as defined in section 897(k)(2)) or)), by any other entity wholly owned by such a fund, or by a trust, corporation, or other organization or arrangement established exclusively to earn income for the benefit of one or more qualified foreign pension funds or entities wholly owned by such a trust, corporation, or other organization or arrangement.".

Comment [CPPIB/OTP7]: Some pension plans, like many governmental plans in the US, are exempt from tax.

Comment [CPPIB/OTP8]: This is from FATCA. Regs § 1.1471-6(f)(1).

Comment [CPPIB/OTP9]: Conformin g change