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Internal Revenue Service
P.O. Box 7604
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Washington, D.C. 20044

Re: Comments on Proposed Section 415 Regulations

Dear Sirs and Mesdames:

This letter comments on the proposed regulations under IRS Code section 415. 70 Fed. Reg. 31214 (May 31, 2005). Specifically, we understand that the Service is seeking comments on the inclusion of certain income earned by nonresident aliens in the definition of Section 415 compensation. This issue is of particular concern to our multinational clients who regularly hire and transfer employees in a worldwide marketplace and from time to time extend qualified plan coverage to foreign workers. As such, we urge the Service to permit foreign source income earned by nonresident aliens to be counted in Section 415 compensation (at least with respect to pensionable compensation). As explained below, this position is supported by a long line of legal, policy, and business considerations. Moreover, any restrictive position in this area should be prospective in nature and only issued in proposed form to allow sufficient time for comments and any necessary design changes.

I. Legal Authority

There is considerable IRS guidance on the treatment of U.S. qualified plan payments to nonresident aliens. None of that authority indicates that foreign source income is excluded for Section 415 purposes – a rule that would greatly limit a nonresident aliens' participation in such plans. Indeed, the authority generally indicates that such participation is permitted. A review of the key authority follows.

A. Section 415 Regulations

The current regulations do not expressly exclude foreign source income from Section 415 compensation. Although the regulations provide that Section 415 compensation includes amounts "includible in gross income," they go on to state that they include foreign earned income (as defined in § 911(b)), whether or not excludable from gross income under section 911.

Moreover, Section 415 compensation "is to be determined without regard to the exclusions from gross income in sections 931 and 933." Treas. Reg. § 1.415-2(i). Lastly, the alternative definitions of compensation (§ 3401(a) wages or W-2 reporting) state that compensation is determined without regard to the "location of the employment." Treas. Reg. § 1.415-2(d)(11)(i), (ii). Accordingly, the current regulations may be unclear, but do not exclude foreign source compensation.

The proposed 415 regulations largely retain the prior language and do not clarify this issue. Therefore, any change in the Service's position should be prospectively only and be issued in proposed form to allow proper time to consider and comment. Moreover, the pending regulations should also consider clarifying, on a prospective basis, the treatment of Section 415 compensation for purposes of determining Highly Compensated Employee under Code section 414(q), where the statute expressly provides for a special rule for nonresident aliens with no U.S. source income. Code § 414(q)(8).

B. Controlled Group Rules

The controlled group rules under Code section 414(b) require that all employees of all corporations that are members of a controlled group of corporations (including foreign corporations) be treated as a single employer for section 415 purposes. Code § 414(b). This provision, in and of itself, implicitly rejects any limitation on the recognition of foreign source income. For example, in private letter ruling 8228116, the Service ruled that nonresident alien employees of foreign subsidiaries within the controlled group may be covered by the parent company's U.S. qualified plan. There was no indication that participation was limited to services performed in the United States.

C. Annuity Payment Exception

Code section 871(f)(1) provides an exclusion from taxation for an annuity payment from a U.S. qualified plan where all the services are performed outside the U.S. by a nonresident alien. This exclusion would have no relevance if Section 415 compensation excluded foreign source income, because there would be no U.S. qualified plan benefit payable to exclude from income.

D. Pension Plan Sourcing Rules

There are a number of special reporting, withholding, and sourcing rules for U.S. qualified plan payments to nonresident aliens. For example, Revenue Procedure 2004-37, 2004-1 C.B. 1099, provides sourcing and taxation rules for defined benefit payments paid to nonresident aliens. Revenue Ruling 79-388, 1979-2 C.B. 270, provides sourcing rules for pension contributions to a U.S. qualified plan attributable to services performed both within and without the U.S. by a nonresident alien. Revenue Ruling 56-446, 1956-2 C.B. 1065, provides that a U.S. pension benefit attributable to services performed entirely abroad by a nonresident alien is not subject to U.S. taxation as a result of a treaty provision. In Clayton v. United States,

33 Fed. Cl. 628 (1995), aff'd 95-2 USTC para. 50,391 (CA-FC 1996), the court ruled that trust earnings paid to nonresident aliens participating in a U.S. qualified plan are sourced within the U.S. and therefore subject to U.S. tax. All of these rulings would largely be irrelevant if only U.S. source income earned by a nonresident alien was eligible for U.S. pension benefits.

II. Public Policy

From a public policy perspective, there is no justification for excluding foreign source income from Section 415 compensation. This position would effectively limit U.S. qualified plans to only U.S. citizens and those who perform substantial services in the U.S. Corporations will no longer have the ability to determine the best benefits structure for their employees, which would clearly have a negative impact on the worldwide marketplace. Coverage under U.S. qualified plans should not be controlled by the location of the services or taxation of the payments. Moreover, any restrictive clarification now could raise plan qualification concerns (e.g., anti-cutback protections) if not applied prospectively.

III. Business Reasons

Counting all compensation paid by the employer for Section 415 purposes, including foreign source income for nonresident aliens that is not otherwise subject to U.S. taxation, is a common practice. This practice is bona fide because it is typical for nonresident aliens to transfer between the U.S. and abroad, and for those same individuals to later become localized in the United States (i.e., become resident aliens that are taxed on worldwide income). Therefore, mandating multiple pension benefits based on the location of employment and resident/non-resident alien status would be administratively onerous and contrary to globalization of U.S. companies. In a worldwide marketplace for talent, a competitive benefits package is critically important, regardless of where the services are performed.

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We appreciate your consideration of these comments especially at this late stage in the process. We would be pleased to respond to any questions.

Respectfully submitted,

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