Internal Revenue Service
memorandum

CC:INTL-174-87
Br3:PJHanley

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OCT 27 1988
International Programs
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to: Internal Revenue Service Representative
OP:I:F:Singapore:JR:KDT

thru: Director, Office of Foreign Programs OP:I:F
from: Senior Technician Reviewer, CC:INTL:Br3

RECEIVED
JAN 19 1989
REVENUE SERVICE REPRESENTATIVE
SINGAPORE, SINGAPORE

subject: Singapore Post Request for general technical opinion

This is in response to your request for a general technical opinion dated January 7, 1987, concerning the proper year of inclusion for U.S. tax purposes of certain compensation paid to U.S. individuals employed in Singapore and the portion, if any, excludible under section 911(a) of the Internal Revenue Code. The material facts presented in your request and in a follow-up memorandum are substantially as set forth below.

FACTS:

Singapore created the Central Provident Fund in 1955. The Fund provides income to an employee who ceases to work because of retirement or disability. Under Singapore law, an employer is required to make contributions on behalf of the employee, but the employer is entitled to deduct from the employee's monthly wages 50 percent of the total amount required to be contributed.

Employees who are not domiciled in Singapore and who are not employed on an employment or professional visit pass are not required to participate in the retirement/disability program. In addition, since June 1981, certain other employees are exempt from participating. An employee not wishing to participate in the program must file an application for exemption within six months from the date of commencement of employment and approval is granted on a case by case basis. One category which generally qualifies for the exemption is the foreign national employee who qualifies for Fund type benefits under similar programs in other countries (such as U.S. nationals covered by Social Security or other pension funds). Most U.S. individuals employed in Singapore are thus exempt from participating.

One of the following conditions must be satisfied before any of the contributions to the Fund on behalf of an employee may be withdrawn: 1) the employee's death, 2) the employee's physical or mental incapacitation, 3) the employee reaches the age of 55, 4) the employee is not a citizen of Singapore and leaves Singapore permanently. Most U.S. individuals participating in the program receive a lump sum distribution upon termination of their employment in Singapore.

Additional salient features of the Fund program are as follows:

1) The "employee's contributions" (the amounts contributed by the employer that are withheld from the employee's wages at the employer's election) to the Fund are withheld by the employer each pay period and, together with the employer's contributions, are paid over to the Singapore government each month. The total amount contributed is held by the government in trust for the employee.

2) The funds, neither in whole nor in part, are subject to the claims of the employer's creditors or the employee's creditors. The funds, once contributed, are set aside for the sole benefit of the employee.

3) The contributions are not forfeitable. The participating employee will receive all of the contributions, together with any interest accrued or paid on them. In the event of the employee's death prior to distribution, the contributions and interest are payable to the employee's designated beneficiary.

4) Under Singapore tax law, the funds contributed by the employer (not including the portion withheld from the employee's wages) are exempt from Singapore tax. That is, those contributions are not included in income by the employee. The portion of the contributions that is withheld from the employee's wages and contributed to the Fund is reported by the employee as income but is deductible by the employee for purposes of determining his taxable income under Singapore law.

ISSUES:

1. Which is the proper year of inclusion for U.S. tax purposes of a) the employer's contributions to the Fund, b) the employee's contributions, and c) any interest earned on those contributions?

2. What portion, if any, of the contributions are excludible from the employee's income under section 911?

LAW AND ANALYSIS:

Section 402(b) of the Income Tax Code provides rules for taxing an employee on contributions made on his behalf by an employer to an employees' trust that is not exempt under section 501(a). Generally, any such contributions made to a trust after August 1, 1969, during a taxable year of the employer which ends within or with a taxable year of the trust for which it is not so exempt shall be included as compensation in the gross income of the employee for his taxable year during which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested at the time the contribution is made. See sections 402(b) and 83(a) of the Code and section 1.402(b)-(1)(a)(1) of the Income Tax Regulations. Property is substantially vested when it is either transferable or not subject to a substantial risk of forfeiture. See section 1.402(b)-(1)(a)(1) and section 1.83-3(b) of the regulations.

Where a portion of an employee's salary is withheld and contributed to a retirement plan, the withholding is mandated by law, and the employee has a vested interest in those amounts when contributed, the amounts are includible in the employee's income when paid into the plan under section 61(a) of the Code. See Rev. Rul. 56-473, 1956-2 C.B. 22; Rev. Rul. 57-326, 1957-2 C.B. 42; and Rev. Rul. 72-250, 1972-1 C.B. 22.

Pursuant to section 402(b), interest earned on the amounts contributed to a trust is taxed when distributed or made available to the employee under section 72 of the Code. See section 1.402(b)-1(b)(7) of the regulations.

Section 911(a)(1) of the Code provides that foreign earned income may be excluded from gross income at the taxpayer's election if the taxpayer is a qualified individual.

Section 911(b)(1)(A) defines the term "foreign earned income" as the amount received by such individual from sources within a foreign country or countries which constitutes earned income attributable to services performed by such individual if certain other criteria, not relevant to this discussion, are met. Section 911(b)(1)(B), however, specifically excludes from the definition of "foreign earned income" income which is included in a taxpayer's gross income by reason of section 402(b).

HOLDING:

The total amount of contributions made to the Fund on behalf of an employee (both employer and employee contributions) are includible in the employee's gross income for the employee's taxable year in which the contributions are made since the contributions are nonforfeitable and, thus, there is no substantial risk of forfeiture of those contributions. The amounts contributed to the Fund on behalf of an employee that are employer contributions are includible in the employee's gross income by reason of section 402(b) of the Code. Thus, pursuant to section 911(b)(1)(B), no portion of the employer contributions constitute "foreign earned income" within the meaning of section 911(b)(1)(A). Therefore, no portion of those amounts are excludible from the employee's gross income under section 911(a). The amounts withheld from the employee's salary and contributed to the Fund as employee contributions are includible in the employee's gross income pursuant to section 61(a). However, those amounts will constitute "foreign earned income," and, thus, are excludible from the employee's gross income, at the employee's election, pursuant to section 911(a)(1), subject to the limitation in section 911(b)(2). Any interest credited to the trust which is attributable to the contributions held in trust for the employee is includible in the employee's gross income when distributed or made available to the employee pursuant to section 72.