UNITED STATES/CANADA CROSS BORDER PENSION ISSUES

By

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I. INTRODUCTION

The United States and Canada share almost 4000 miles of border. It is quite common for citizens of one country to work in the other country, either permanently, or on a temporary basis. In certain border areas, citizens commute on a daily basis between their homes in one country and their workplace in the other.[1] The tax treaty between the United States and Canada, approved on 26 September 1980, has been amended by a number of Protocols, most recently in September 2007, by the Protocol Amending the Convention between the United States of America and Canada with respect to Taxes on Income and on Capital (the "2007

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[1] For example, many residents of Ontario commute on a daily basis over one of the four bridges near Buffalo, New York or commute to Michigan. It is estimated that trade transversing the U.S.-Canada border exceeds $1billion per day. Niagara Falls crossings are estimated at $26 billion per year. The Whirlpool Bridge over the Niagara River is a dedicated commuter crossing under the NEXUS pre-authorization entry program, expediting clearance through Canadian and U.S. Customs.

Protocol").[2] The pensions provisions of the 2007 Protocol became effective January 1, 2009.

Article 13 of the 2007 Protocol deleted and replaced Paragraphs 3, 4 and 7 of Article XVIII (Pensions and Annuities) of the Convention and added 10 new paragraphs to Article XVIII. These changes are intended (i) to remove barriers to the flow of personal services between the US and Canada that could otherwise result from discontinuities in the laws to the two states regarding the deductibility of pension contributions, (ii) to address workers on short-term assignments in the other state, *e.g.*, to address issues of cross-border commuters, (iii) to address the special case of a U.S. citizen who is a resident of Canada and participates in a qualifying retirement plan in Canada, (iv) to provide (A) a definition of a "qualifying retirement plan", (B) a source rule to apply to distributions from a pension or retirement plan, and (C) a special rule for partnerships.

Following in Part I is a description of the 2007 Protocol as explained in the Department of Treasury Technical Explanation of the Protocol done at Chelsea on September 21, 2007 Amending the Convention between the United States of America and Canada with respect to Taxes on Income and on Capital done at Washington on September 26, 1980, as amended y the Protocols done on June 14, 1983, march 28, 1994, March 17, 1995, and July 29, 1997. Part II is an excerpt from the 2009 Report of the Advisory Committee on Tax Exempt and Government Entities to the Commissioner of the U.S. Internal Revenue Service "International Pension Issues in a Global Economy: A Survey and Assessment of the IRS's Role in Breaking Down the Barriers."

PART I – THE 2007 PROTOCOL

A. DEFINITION OF "PENSIONS"

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[2] The 1980 Tax Treaty between the US and Canada had previously been amended by Protocols done on 14 June 1983, 28 March 1984, 17 March 1995 and 29 July 1997. (The Tax Treaty prior to its amendment by the 2007 Protocol is referred to as the "Convention.")

Subparagraph 3(a) of Article XVIII provides that the term "pensions" includes any payment under a superannuation, pension, or other retirement arrangement, including military pensions and allowances and amounts paid under a sickness, accident or disability plan, but does not include an income-averaging annuity contract or social security benefits. Thus the term "pensions" includes pensions paid by private employers (including pre-tax and Roth 401(k) plans) as well as any pension paid in respect of government services. It includes payments from individual retirement accounts (IRAs) in the United States and from registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) in Canada.

Subparagraph 3(b) of Article XVIII, added by the 2007 Protocol, provides that the term "pensions" generally includes a Roth IRA. Thus distributions from a Roth IRA to a resident of Canada, in general, continues to be exempt from Canadian tax to the extent it would have been exempt under US tax law. In addition, residents of Canada may elect to defer any taxation in Canada with respect to income accrued in a Roth IRA until distributed. In most cases, no portion of a Roth IRA will be subject to tax in Canada.

However, if additional contributions are made to the Roth IRA while a resident of Canada (other than a rollover contribution from another Roth IRA), the Roth IRA will cease to be considered as "pension" and will be subject to tax in Canada in the year of accrual to the extent of such contributions.

B. TAXATION OF DISTRIBUTIONS

Paragraph 7 of Article XVIII, amended by the 2007 Protocol, continues to provide a rule with respect to the taxation of a natural person on income accrued in a pension or employee benefit plan in the other Contracting State. This rule applies to an individual who is a citizen or resident of one Contracting State and is a beneficiary of a trust, company, organization or other arrangement that is a resident of the other Contracting State, where such entity is generally exempt from income taxation in that other State, and is operated exclusively to provide pension or employee benefits. In such cases, the beneficiary may elect to defer taxation in his State of residence on income accrued until it is distributed from the plan.

Two changes were made by the 2007 Protocol. First, the phrase “pension, retirement or employee benefits” is changed to “pension or employee benefits” solely to reflect that in certain cases Roth IRAs will not be treated as pensions for purposes of Article XVIII. The second change is to make clear that an election to defer taxation with respect to undistributed income accrued in a plan is not dependent on whether there are specific rules for making an election in the individual’s resident State.

C. CROSS-BORDER PENSION CONTRIBUTIONS

New paragraphs 8 through 17 to Article XVIII deal with cross-border pension contributions. The purpose of these changes is to address the issue where one country allows deductions or exclusions for its residents for contributions, made by them or their behalf, to resident pension plans, but does not allow deductions or exclusions for payments made to plans resident in another country – even if the structure and legal requirements are similar.

1. Workers on short-term assignments in the other Contracting State

Paragraphs 8 and 9 concern an individual who is a participant in his home State qualified plan but is on a short-term assignment in the other State (the “host State”). Provided certain requirements are met, contributions made to, or benefits accrued under, the home State plan will be deductible or excludible in computing the individual’s income in the host State. Further, contributions made to the plan by the individual’s employer will be allowed as a deduction in computing the employer’s profits in the host State.

Requirements for this treatment include: (i) the remuneration received by the individual with respect to services performed in the host State must be taxable by the host State;[3] (ii) the individual must have been a participant in the plan immediately before he began performing services in the host State; and (iii) the

[3] For example, if the host State is the United States, the income earned by the individual on the short-term assignment cannot be excludible from US taxes under Code section 893.

individual must not have been a resident of the host State immediately before he began performing services in the host State.[4]

These tax benefits are available only if the individual has performed services in the host State for no more than 60 of the 120 months preceding the individual's current taxable year and only to the extent he performs services in the host State for the same employer. The contributions and benefits must be attributable to services performed in the host State and must be made or accrued during the period he performs those services. This 60-month time period limits the period of time for which the host State will be required to provide benefits for contributions to a plan from which it is unlikely to be able to tax the distributions. The requirement that the contributions or accrual be related to the period of the individual's employment in the host State prevents the individual who renders services only for a short period in the host State from making disproportionately large contributions to home State plans in order to offset the tax liability associated with the income earned in the host State.

To the extent the individual receives benefits in the host State for contributions or accruals to a home State plan, the same services may not be taken into account under a host State plan. The purposed of this rule is to prevent double benefits attributable to the same services. For example, an individual who is working temporarily in the United States and making contributions to a qualified retirement plan in Canada with respect to services performed in the United States may not make contributions to an individual retirement account with respect to the same services.

The tax benefit is available only to the extent that the contributions or benefits would qualify for tax relief in the home State if the individual were a resident of and performed services in that State. Thus benefits would be limited in the same way as if the individual continued to be a resident of the home State. A special rule applies if the individual is a citizen of the United States and the host State is the

[4] A US citizen who has been a resident of Canada may be entitled to benefits under paragraph 8 if (a) he performs services in the United States for a limited period of time and (b) he was a resident of Canada immediately before he began performing such services.

United States (e.g. the individual is a resident of Canada), then the benefits granted to such an individual are limited to those allowed by the United States to its residents for contributions to, or benefits otherwise accrued under, a generally corresponding U.S. qualified plan. In other words, the lower of the two limits will apply and the rule ensures that U.S. citizens working temporarily in the United States and participating in a Canadian plan will not be given more favorable U.S tax treatment than U.S. citizens participating in a U.S. plan.

Where the United States is the home State, the amount of contributions that may be excluded from the employee's income for Canadian purposes is limited to the U.S. dollar amount specified under Code §415 or §402(g)[5] to the extent the contributions are made from the employee's compensation.

Where Canada is the home State, the amount of contributions that may be excluded from the employee's income for U.S. tax purposes is the amount specified in subsections 146(5), 14(8), 147.1(8) and (9) and 147.2(1) and (4) of the Income Tax Act and paragraph 8503(4)(a) of the Income Tax Regulations, as applicable. If the employee is a U.S. citizen then the exclusion is limited to the lesser of this amount or the amount specified in the immediate preceding paragraph.

The 2007 Protocol provides that the employer in the host State may also take a deduction for contributions to the home State plan even though such a deduction might not be allowable under the domestic tax law of the host State. This deduction is also available to an affiliate of the employer, e.g. a parent company of individual's employer where the contributions made by the parent company are treated under the law of the host State as contributions by the individual's employer. For example, the contribution of a Canadian parent company to its Canada plan for an individual who is temporarily working for a U.S. subsidiary of the Canadian parent will be deductible by the U.S. subsidiary because under U.S. law, it would be treated as a contribution by the subsidiary. The amount of the allowable deduction will be determined under the laws of the home State, as if the individual were a resident of, and performed services in, the home State.

[5] This dollar amount would include the age 50 catch-up.

D. CROSS-BORDER COMMUTERS

The 2007 Protocol added paragraphs 10, 11 and 12 to Article XVIII which address the situation where a resident of one State (the "residence State") performs services in the other State (the "services State") and is a member of a "qualifying retirement plan" in the services State. Provided certain requirements are met, contributions made to, or benefits accrued under, the qualifying retirement plan by or on behalf of the individual will be deductible or excludible in computing the individual's income in the residence State.

First, the individual must perform services as an employee in the services State, the remuneration attributable to such services must be taxable in the services State, and that remuneration must be paid by, either an employer who is resident in the services State or by a permanent establishment that the employer has in the services State. The contributions and benefits must be attributable to those services and must be made or accrued during the period the individual performs such services.

Second, the tax benefit applies only to the extent that the contributions or benefits qualify for tax relief in the services State, i.e., the exclusion is limited in the same way as was limited in the case of the cross-border pensions, described above. However, the tax benefits granted by the residence State may not exceed the benefits that would be allowable under the domestic law of the residence State.

Where Canada is the residence State, the amount of contributions otherwise allowable as a deduction may not exceed the individual's deduction limit for contributions to registered retirement savings plans (RRSPs) remaining after taking into account the amount of individual's contribution to RRSPs deducted under Canadian tax law for the year. The amount deducted pursuant to the 2007 Protocol will be taken into account in computing the individual's deduction for subsequent tax years for contributions to RRSPs.

Where the United State is the residence State, the benefits granted to an individual may not exceed the benefits that would be allowed under U.S. law to its residents for contributions to, or benefits otherwise accrued under a corresponding U.S.

qualified plan. For purposes of determining the eligibility of the individual to participate in and receive tax benefits with respect to a pension, retirement plan or other retirement arrangement in the United States, contributions made to, or benefits accrued under, a qualifying plan in Canada by or on behalf of the individual are treated as contributions or benefits under a generally corresponding U.S. qualified plan. Thus, participation in a Canadian plan would be taken into account in determining whether the individual is an "active participant" and thus limiting his ability to make contributions to a U.S. individual retirement account.[6]

E. U.S. CITIZENS RESIDENT IN CANADA

The 2007 Protocol provides specifically for U.S. citizens who are resident in Canada and who perform services in Canada and participate in a qualifying retirement plan in Canada. Provided certain requirements are met, contributions made to, or benefits accrued under, a Canadian qualifying retirement plan by or on behalf of the U.S. citizen will be deductible or excludible in computing his or her taxable income in the United States.[7]

In order for this tax benefit to apply, the U.S. citizen must perform services as an employee in Canada, the remuneration attributable to such services must be taxable in Canada which remuneration is paid either by an employer who is resident of Canada or by a permanent establishment that the employer has in Canada. The contributions and benefits must be attributable to those services and must be made or accrued during the period the individual performs such services. Similar to the provisions described above, the tax benefit is available only to the extent the contributions or benefits would be provided with a deduction or exclusion under Canadian or U.S. tax law, whichever is lower.[8]

For purposes of determining the eligibility of the individual to participate in and receive tax benefits with respect to a pension, retirement plan or other retirement arrangement in the United States, contributions made to, or benefits accrued under,

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6 Because the employer is located in the services State, it is eligible for deductions under the domestic tax law of the services State and thus no special provision is needed.

7 These provisions are generally consistent with paragraph 4 of Article 18 of the U.S. Model treaty.

8 An individual may not claim tax benefits under the 2007 Protocol with respect to services the remuneration for which is excluded under Code §911(a).

a qualifying plan in Canada by or on behalf of the individual are treated as contributions or benefits under a generally corresponding U.S. qualified plan. Thus, participation in a Canadian plan would be taken into account in determining whether the individual is an "active participant" and thus limiting his ability to make contributions to a U.S. individual retirement account.

F. DEFINITION OF "QUALIFYING RETIREMENT PLAN"

With respect to the new cross-border provisions of the 2007 Protocol, a "qualifying retirement plan" is a trust, company or other arrangement that is resident in Canada or the United States, generally exempt from income tax in that State and operated primarily for the purpose of providing pension or retirement benefits and which the competent authority of the other State agrees generally corresponds to a pension or retirement plan established in and recognized for tax purposes in that State, but is not an individual arrangement with respect to which the employer has no involvement. Thus U.S. individual retirement arrangements (IRAs), Canadian registered retirement savings plans (RRSPs) and Canadian retirement compensation arrangements (RCAs) are not "qualifying retirement plans" for purposes of the 2007 Protocol unless specifically addressed therein.

The General Note[9] to the 2007 Protocol provides that the following Canadian plans constitute qualifying retirement plans: registered pension plans under section 147.1 of the Income Tax Act, registered retirement savings plans under section 146 that are part of a group arrangement described in subsection 204.2(1.32), deferred profit sharing plans under section 147, any registered savings plan under section 146, and any registered retirement income fund under section 146.3 that is funded exclusively by rollover contributions from one or more of the preceding plans.

The General Note also provides that the following U.S. plans constitute qualifying retirement plans: qualified plans under Code section 401(a) (including section 401(k) arrangements), individual retirement plans that are part of a simplified employee pension plan under section 408(k), Code section 408(p) simple retirement plan accounts, Code section 403(a) qualified annuity plans, Code section

[9] See Paragraph 10 of the General Note

403(b) plans, Code section 457(g) trusts providing benefits under Code section 457(b) plans, the Thrift Savings Fund (Code section 7701(j), and any individual retirement account under Code section 408(a) that is funded exclusively by rollover contributions from one or more of the preceding plans.[10]

G. SOURCE RULE

The 2007 Protocol provides that a distribution from a pension or retirement plan that is reasonably attributable to a contribution or benefit for which a benefit was allowed under paragraph 8, 10 or 13 of Article XVIII will be deemed to arise in the State in which the plan was established.

H. PARTNERSHIPS

The 2007 Protocol provides that these new cross-border pension rules apply, with such modifications as may be required, as though the relationship between a partnership that carries on a business, and an individual who is a member of the partnership, were that of employer and employee. Since certain provisions of the 2007 Protocol apply only to employees and employers, this final provision assures that partners participating in a plan established by their partnership may be eligible for these benefits.

PART II- 2009 Report of the Advisory Committee on Tax Exempt and Government Entities to the Commissioner of the U.S. Internal Revenue Service "International Pension Issues in a Global Economy: A Survey and Assessment of the IRS's Role in Breaking Down the Barriers."

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V. 5. Multiemployer Plans – Canada

[10] If the type of plan in which a taxpayer participates is not described in the 2007 Protocol as a "qualifying retirement plan", a taxpayer may request a determination from the competent authority of the other State that the plan generally corresponds to a pension or retirement plan established in and recognized for tax purposes in that State.

Responsibility – IRS TE/GE and Counsel, Treasury, and Congress

Background

Within Canada, worker mobility from one province to another is facilitated, in part, by plans similar to what are referred to in Canada as "multiemployer plans." In general, these are plans which are collectively bargained, but may be sponsored and maintained by employers and/or by a union. Because each Canadian province has its own pension rules, these multiemployer plans are essential to Canadian businesses where the employer transfers employees from a workplace in one province to an affiliate located in another province and to ensure the mobility of skilled labor to where it is needed most.

Canadian multiemployer plans typically provide a cents or dollar per hour pension, rather than a compensation or service-based pension. The Canadian plans typically have reciprocal agreements among them that allow contributions for a worker to be made to the worker's "home" plan. Such plans are particularly important in the construction and entertainment industries. For example, a Canadian entertainer may have several short-term jobs in different provinces in Canada; these agreements would permit benefit accruals or contributions under a qualified Canadian plan to be consolidated into one plan, regardless of where the individual works. However, if a Canadian resident-entertainer works both in the United States and in Canada in a given year, there is limited ability to provide coverage under a Canadian plan relating to the compensation for services rendered in the United States. Similarly, Canadian construction workers may work on both United States and Canadian projects each year.

Article 13 of the Fifth Protocol to the United States-Canada 1980 Income Tax Treaty (the "Canadian Protocol" [referred to above as the "2007 Protocol"]) provides for a deduction or exclusion from income in the Contracting State in which the individual is working and covered by a qualifying retirement plan in the other Contracting State provided the individual is not a resident in the other State, but only for certain temporary periods and subject to certain requirements.

Issues

While the multiemployer plan concept is helpful within Canada, challenges arise when workers cross the border to work in the United States or when U.S. residents and workers cross the border to work in Canada. Cross-border work problems include the following:

- Canadians who work in their industry in Canada and then accept temporary assignments in the United States cannot have the U.S. employer's contributions made to the workers' "home" plan in Canada because of United States tax rules, unless the individual can claim benefits under the Canadian Protocol for years beginning on or after January 1, 2009.[11]

- U.S. employees who temporarily work in Canada cannot have retirement contributions of Canadian employers made to the U.S. employees' "home" plan, unless the Canadian Ministry of Finance approves the U.S. plan, or unless the individual can claim benefits under the Canadian Protocol for years beginning on or after January 1, 2009.

- Vesting schedules differ between Canada (2 years) and the United States (typically 5 or 6 years). This could mean that pensions may be forfeited with respect to work in the United States when those pensions would not be forfeited if the work were performed in Canada.

- It is not easy to provide a Canadian who transfers to a U.S. location with a Canadian pension and a U.S. pension that would add up to the pension that would be earned for employment exclusively in Canada. Further, the plan benefits cannot be transferred from a U.S. qualified plan to a Canadian qualified plan, or vice versa, without tax consequences to the participant and possible disqualification of one or both plans.

[11] There are some plans that are dual-qualified in both Canada and the United States, *e.g.,* the National Hockey League Pension Plan.

- Qualification of a U.S. pension plan is required by Canadian law for workers in Canada to remain in a U.S. pension plan, unless the individual can claim benefits under the Canadian Protocol for years beginning on or after January 1, 2009. This is somewhat similar to dual-qualified plans in Puerto Rico—however, there are stricter pension accrual limits in Canada[12] than under the U.S. qualified plan rules, and Canadian plans are not subject to ERISA as are Puerto Rico plans.

- Canadians can accumulate pensions in U.S. plans that meet the requirements of a "Foreign Registered Plan." This is an exception to the dual qualification requirement, but requires application to the Canada Revenue Agency.

- Canadian tax issues arise if a deferred compensation plan is either unfunded or if an annuity is purchased. There are Canadian law compliance issues if the compensation is pre-funded.

Recommendations

The United States should consider entering into negotiations to allow employer retirement contributions to "follow" a worker. For example, a Canadian working temporarily in Michigan should be permitted to have retirement contributions by the Michigan employer transferred to the worker's home plan in Canada when the transferred employee returns to Canada.

6. **Treaty Issues**

Responsibility – IRS LMSB, TE/GE, and Counsel, and Treasury

Background

Other than the minority of instances where alternative provisions are specifically adopted, most pension/annuity articles of bilateral tax treaties with the United States provide that the country of residence (as determined under the treaty's

[12] There is a maximum benefit accrual rate of 2% under Canada tax pension rules.

residency article which contains tie breaker rules when more than one residency is established) may tax a person's pension or annuity under its domestic laws. Some treaties provide that the country of residence may not tax amounts that would not have been taxable by the other country if the person were a resident of that country. In some cases, government pensions/annuities or social security system payments may be taxable by the government making the payments. There also may be special rules for lump sum distributions. Thus, it is necessary to review each tax treaty independently in order to determine the applicable rules.[13]

Although many of the bilateral tax treaties address the taxation of distributions from employer pensions/annuities, there are only ten treaties and two protocols that address the taxation of contributions to employer pensions/annuities.[14]

The 1996 Model Income Tax Treaty included pension contribution provisions as does the 2006 Model Income Tax Treaty.[15] The 1996 Model provided that contributions would be deductible (or excludible) for purposes of determining an employee's tax liability in the host country and required that (1) the employee must have been contributing to the home country plan before beginning to work in the host country, (2) the plan must be similar to one for which the home country would provide such a deduction (or exclusion), and (3) the deduction (or exclusion) is limited to the amount that would be allowed for such a plan. It also provided for a deduction to the contributing employer against its taxable income in the host country.[16] The 2006 Model also requires that the competent authority of the host State determine that the pension fund to which the contribution is made in the other (residency) State generally corresponds to the plan in the host

[13] *See* IRS, International Tax Gap Series, *The Taxation of Foreign Pension and Annuity Distributions* (October 2008) available at www.irs.gov/businesses/article/0,,id=187083,00.html.

[14] These include U.S. treaties with France, The Netherlands, Sweden, Austria, Switzerland, Ireland, the United Kingdom and Belgium, and protocols with Germany and Canada. There is also a pending treaty with Italy. *See*, Fleeman, M. Grace, *Cross-Border Pension Contributions,* The Tax Journal, June 23, 2008, at 11-12.

[15] United States Model Income Convention of November 15, 2006 (the "2006 Model Income Tax Treaty"), Article 17 ("Pensions, Social Security, Annuities, Alimony, and Child Support"), Article 18 ("Pension Funds").

[16] Fleeman, *supra* note 30, at 12.

State.[17] It also provides U.S. tax treatment for certain contributions by or on behalf of U.S. citizens who are residents in another State to pension funds established in that other State that is comparable to the treatment that would be provided for contributions to U.S. pension funds. This tax benefit is limited to the lesser of the amount of relief allowed for contributions and benefits under a pension fund established in the other State and the amount of relief that would be allowed for contributions and benefits under a generally corresponding pension fund established in the United States.[18]

Each of the bilateral treaties is negotiated between the United States and the other contracting state and results in various permutations. For example, the treaties with Switzerland (1996) and Ireland (1997) impose a five-year limit on how long an employee may qualify for benefits under the provisions. The treaty with the United Kingdom (2001) has special rules for U.S. citizens who live in the U.K. and participate in a U.K. pension scheme. A special commuter provision is included in the Canadian Protocol, which permits cross-border workers to deduct contributions made to a pension plan or other employment-related retirement plan in the country of employment.[19]

Many treaties provide relief where the competent authority has determined the types of plans that are covered by the treaty provisions. This requires the U.S. competent authority to agree that the foreign plan generally corresponds to a plan recognized for tax purposes in the United States. In the earlier treaties, each individual desiring to take advantage of the treaty provision (or the plan sponsor) needed to obtain a ruling that the foreign plan generally corresponded to a plan

17 The Model Income Convention of September 20, 1996 (the "1996 Model Income Tax Treaty") also contained this requirement in Article 18, paragraph 6(d)(ii).

18 2006 Model Income Tax Treaty, Article 18; United States Model Technical Explanation Accompanying the United States Model Income Tax Convention of November 15, 2006, 56-58.

19 Department of Treasury Technical Explanation of the Protocol Done at Chelsea on September 21, 2007 Amending the Convention Between the United States of America and Canada With Respect to Taxes on Income and on Capital Done at Washington on September 26, 1980, as amended by the Protocols Done on June 14, 1983, March 28, 1984, March 17, 1995, and July 28, 1997 ("Technical Explanation of the U.S.-Canada Protocol") (2008), available at http://www.treas.gov/press/releases/reports/tecanada08.pdf. Note, although Roth IRAs are treated as retirement plans under the taxation of distributions from pension plans provision of the U.S.-Canada Protocol, Roth IRAs do not receive the same treatment under the contribution provisions of the Protocol and are treated as taxable contributions to a savings account.

recognized for tax purposes in the United States, requiring submission of all the plan documents (translated into English, if necessary).

The IRS has begun to enter into competent authority agreements with the other contracting state that lists the types of plans in each country that are understood to generally correspond to plans recognized for tax purposes in the other country.[20] In some cases these plans are actually listed in the Treaty, the Protocol or the Exchange of Notes relating to the treaty.[21]

Issues

Not every country that has entered into a bilateral treaty with the United States has compiled an agreed upon list of the approved plans to be covered by the treaty ("comparable plans").

Treaties are robust on protecting "qualified" or "approved" retirement plan accumulations, but do not provide similar protection for non-qualified plans where they are designed to work with the base retirement plan ("restoration" type plans).

IRAs are not specifically addressed in most treaties[22] and need to be contemplated or additional guidance provided. The ACT acknowledges that there is a significant difference of opinion between the US and other countries with whom pension provisions have been negotiated on the characterization of IRAs. The US considers IRAs to be pension plans; other countries consider IRAs to be savings plans in most part due to their "demand account" status. The ACT

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[20] Such agreements have been entered into with The Netherlands (2000 and 2007) and Switzerland (2004).

[21] *See,* Protocol Amending the Convention Between the United States of American and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, August 29, 1989 (the "German Protocol") and the United States response to United Kingdom Note regarding the U.S – U.K. Double Taxation Convention, July 24, 2001 (the "U.K. Exchange of Notes). The hierarchy of authority is as follows (in order of importance):

- Treaty
- Protocol
- Exchange of Notes
- Technical Explanation – (either a Treasury unilateral document or the product of negotiation (e.g., Canada))

[22] *But, see,* Canadian Protocol, Article 13, amending Paragraphs 3 and 4 of Article XVIII of the Treaty.

understands that this may provide a barrier in providing additional guidance in the area.

There are some procedural problems with complying with treaty requirements for filing forms claiming treaty protection. For example, most foreign plans are funded on a monthly or quarterly basis. Thus, where a bilateral treaty has a provision stating that a U.S. Person working in the other country would not have to recognize the contribution to or accrual under a U.S. plan with respect to tax liability in the foreign country, the individual is required to complete and deliver Form W-8BEN to the U.S. payer to take advantage of this treaty provision.

Another procedural problem is presented by the situation in which an employee lives in the United States and receives a pension/annuity from a foreign country. In this situation, the individual must claim the desired treaty withholding exemption on the form and in the manner specified by the foreign government. If the foreign government and/or the foreign withholding agent refuse to honor the treaty claim, the individual may make the treaty claim on his personal income tax return, or other prescribed form, filed with the foreign country. Additionally, a foreign tax credit on the individual's U.S. federal income tax return may be available for any foreign income tax withheld from the foreign pension or annuity.[23]

Recommendations

a. Although some bilateral treaties specify the home country pension plans/schemes that are deemed to be comparable,[24] a number of other treaties do not contain such specificity. Guidance containing general principles that could be applied to determine comparability would be helpful. Perhaps for countries that have an employer-based private pension system, the Code § 409A definition of "broad-based foreign retirement plan" could be used."

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[23] *See* footnote 12 and accompanying text, *supra*.

[24] *See* for example, the Technical Explanation to the 2001 U.S. – U.K. Treaty (2003), Art. 3, Par. (o) for a list of the U.S. and U.K. plans that are deemed to be comparable.

b. An internal working group between Treasury, Chief Counsel, IRS TE/GE Employee Plans, and LMSB should be formalized to address treaty issues and to provide input regarding treaty negotiations. Clarification is needed as to where jurisdiction resides with respect to treaty issues that impact multiple business units within IRS and Treasury. Some of the issues to be reconciled by this working group include the following:

- what constitutes a comparable plan[25] and whether the U.S. and foreign competent authorities can enter into agreements to list comparable plans when the treaty does not contain a list;

- what constitutes a pension fund in another country (e.g., must the pension fund be a funded plan, must the pension fund meet foreign local requirements, are grantor trusts treated as funded plans in a foreign country);

- how contributions and dividends to foreign trusts are taxed;

- what is the permissibility and appropriate treatment of IRAs and rollovers[26];

- whether non-qualified "wrap" or restoration plans can be included as comparable plans; and

- whether U.S. citizens are taxed on accruals and earnings in other countries.

c. The IRS should recognize the disconnect between the time at which a determination is made regarding treaty coverage and the time for filing returns required to take advantage of treaty provisions, which is usually after the end

[25] For example, in France it is difficult to distinguish between the social security system and a pension plan.

[26] Rollover provisions were not included in the 2006 Model Income Tax Treaty (see footnote 31, *supra*) because of problems with the rollover provisions in the 1996 Model Income Tax Treaty (which were used in the treaty with South Africa).

of the taxpayer’s tax year, and provide some flexibility as to the time for filing the required forms.

d. Reconsider the necessity of having nonresident aliens participating in U.S. plans obtain a TIN to be used on required filings to claim treaty relief when no tax revenues are involved.

Treaty negotiators should take into account that retirement income comes from more than one source. Mobile workforces typically need non-qualified benefits to make them whole as they move from country to country.