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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

201130017

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

MAY 02 2011

T:EP:RA:A2

A =
B =
Country C =
Date D1 =
Date D2 =
Date D3 =
Pension Plan and Fund F =
Organization O =

Dear

This ruling reflects a change made to Date D3 and supersedes our ruling dated March 8, 2011 concerning the income tax treatment of annuity benefits receivable by you from Pension Plan and Fund F, the retirement plan for Organization O.

According to the information submitted, you became eligible for pension annuity benefits for life commencing on Date D1, in the amount of $ per month, and adjusted annually for cost of living. If B survives you, she will be entitled to annuity payments of $ per month (also adjusted for cost of living). You also elected to have the pension fund transfer to an IRA 1/3 of the present value of your contract, or $, in connection with the commencement of your annuity. Your annuity benefit as stated above is the reduced amount to reflect this distribution under your contract. You were born Date D2. B was born Date D3. You are a resident of Country C.

You are a citizen of the U.S., and were a citizen of the U.S. while employed by Organization O. Before you retired, you contributed $60,670.25 to the Pension Fund F. These employee contributions were includible in your gross income under U.S. tax law. Over the same period your employer contributed an amount to the fund on your account. These employer contributions were not included in your income for U.S. tax purposes. The Pension Fund F is organized within the

U.S. and distributions under the Plan to you are considered to arise within the U.S. According to your representation, Pension Plan and Fund F is a U.S. qualified pension plan. Based on the above facts and representations, you requested a ruling as to the correct income tax treatment of the annuity payments as if you were a U.S. resident. The tax treatment that would apply if you were a resident of the U.S. affects your tax treatment under the tax laws of Country C.

I. INTERNATIONAL CONSIDERATIONS

Under the United States – Country C Income Tax Treaty (the Treaty), Article XVIII(1), Country C may tax its residents on pensions arising in the U.S. only to the extent such payments would be included in U.S. gross income if they had been received by a resident of the U.S. The determination of whether these payments arise within the U.S. must be made under Country C law. It is your representation that Country C considers the above pension payments to arise within the U.S. in their entirety. Therefore, Article XVIII(1) applies to such payments.

Generally, pension payments arising within the U.S. paid to a U.S. resident are included in gross income under section 72 of the Internal Revenue Code of 1986 (the Code), but subsection 72(b) excludes from income that portion of each payment which represents a return of the investment in the contract. The employee's own contributions which were includible in his gross income at the time contributed generally constitute his investment in the contract.

II. RULES APPLICABLE TO PAYMENTS UNDER ANNUITY CONTRACT

Section 72(b) of the Code provides that gross income does not include that portion of each payment which represents a return of your investment in the contract. For any annuity starting before November 16, 1996, the General Rule of section 72(b) would be applicable for determining the excludible amount. However, Notice 88-118 (1988-2 C.B. 450) allowed retirees to elect to apply the simplified rule contained therein rather than the General Rule for determining the excludible amount. You have elected to use the simplified rule. The computation under this rule requires first determining the investment in the contract as of the annuity starting date.

III. LUMP SUM PAYMENT RETURN OF INVESTMENT

Section 72(e) of the Code provides for the treatment of payments received under an annuity contract but received not as an annuity, such as lump sum distributions. Section 72(e)(2) distinguishes different treatments for a lump sum paid before or after the start of an annuity. In this case, the lump sum was paid on the same day as the annuity starting date. However, the election to receive the lump sum was made before the annuity starting date, and the annuity rate, from the first day of the annuity obligation, reflected the reduced account balance resulting from the payment of the lump sum. Section 72(d)(1)(D) provides that if a lump sum is paid from a qualified plan in connection with the commencement of an annuity, it is to be treated as being paid before the annuity starting date, even if the actual date of its transfer is not before the annuity starting date. For these purposes, your lump sum payment is treated as paid before the start of the annuity.

Section 72(e)(8) of the Code determines the tax treatment of a lump sum payment that is paid under a qualified plan before the start of the annuity. The ratio of the investment in the contract to the account balance establishes the portion of the entire lump sum payment that is excludible from income as a return of your investment in the contract. With a defined benefit plan an account balance is often not available, but we will accept the present value of your contract as representative of the account balance. Since your lump sum payment was 1/3 of the present value of the contract, the total present value of the contract was $. Your employee contribution amount of $ is your investment in the contract. The ratio of the investment in the contract to the account balance is 15.9 percent. Therefore 15.9 percent of the lump sum payment, or $, represents a return of your investment and is non-taxable. After this, your remaining investment in the contract is .

IV. ANNUITY PAYMENTS

Under the simplified Safe Harbor Rule of Notice 88-118, the monthly exclusion amount is found by dividing your investment in the contract by a divisor based on your age. Since your age at the annuity starting date was at least age 55 and below age 60, the divisor is 260. Your contributions to the plan, reduced by the tax-free part of the lump sum payment, constitute the remaining investment in the contract for purposes of the simplified rule. Therefore, considering your situation as if you were a U.S. resident, your monthly exclusion amount would be $ / 260 or $. This amount would be excludible from gross income for each annuity payment received under the contract, until the total amount under the contract so excluded equals the total investment in the contract.

This ruling is limited to the issues expressly stated herein. We are expressing no opinion as to the taxability or non-taxability of any payments for a nonresident alien.

You may need to attach a copy of this ruling to the initial tax return in which you apply the above exclusion rule. We are enclosing a copy for your Country C tax return.

If you have any question concerning this matter, please

Sincerely,

David M. Ziegler
Manager, Actuarial Group 2
Employee Plans Technical