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memorandum

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from: M. Grace Fleeman
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subject: U.S. Pension Rollover

This Chief Counsel Advice responds to your request for assistance dated December 27, 2011, regarding the possible application of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support) and Article 18 (Pension Schemes) of the U.S.-U.K. income tax treaty[1] (the "Treaty") to a transfer from a U.S. pension scheme to a U.K. pension scheme. This advice may not be used or cited as precedent.

LEGEND

Taxpayer	=
Tax Year	=
U.S. University	=
U.K. Plan	=
U.S. Plan	=
U.S. Investment Company	=
Date 1	=

[1] Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed on July 24, 2001, as amended by a Protocol signed on July 19, 2002.

Date 2	=
Date 3	=
Year 1	=
Year 2	=
$ Amount	=

ISSUES

1. Whether a U.K. resident individual may rely on the parenthetical language in Article 18(1) of the Treaty to make a tax-deferred rollover distribution from a U.S. pension scheme to a U.K. pension scheme that is not an "eligible retirement plan" within the meaning of section 402(c)(8)(B) of the Internal Revenue Code (the "Code").

2. Whether a lump-sum transfer from a U.S. pension scheme to a U.K. pension scheme that is not an eligible retirement plan is taxable as a distribution in the United States pursuant to Article 17(2) of the Treaty.

CONCLUSIONS

1. No. The U.K. pension scheme is not an "eligible retirement plan" within the meaning of section 402(c)(8)(B) of the Code, and nothing in Article 18(1) of the Treaty overrides the requirement that a tax-deferred rollover distribution can be made only to an eligible retirement plan.

2. Yes. A lump-sum transfer from a U.S. pension scheme to a U.K. pension scheme that is not an eligible retirement plan is taxable in the United States as a distribution pursuant to Article 17(2) of the Treaty.

FACTS

For Tax Year, the year at issue, Taxpayer was a resident of the United Kingdom and a nonresident alien for U.S. income tax purposes. Taxpayer is a university professor and has worked for most of his career at various universities located in the United Kingdom. Over his working life, he has contributed to U.K. Plan, a qualified pension scheme under U.K. law. In Year 1, Taxpayer accepted a position at U.S. University where he worked from Date 1 through Date 3. After Date 3, he returned permanently to the United Kingdom.

During the period Taxpayer worked at U.S. University, he was a member of U.S. Plan that invested in a section 403(b)(7) custodial account operated by U.S. Investment Company. When Taxpayer returned permanently to the United Kingdom, he sought professional advice regarding the ability to roll over his balance in U.S. Plan to a U.K. pension scheme. HMRC advised Taxpayer in a letter, dated Date 2, that the details of the receiving scheme should be given to the administrators of the U.S. scheme so they might consider the request and advise whether or not the proposed transfer would be permitted under the scheme rules.

On Date 3, U.S. Plan issued a lump-sum check for $ Amount payable to U.K. Plan. Taxpayer received a Year 2 Form 1099-R (Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.) issued by U.S. Investment Company reporting a gross distribution of $ Amount.

Taxpayer has not filed a U.S. income tax return for Tax Year and has not paid any U.S. income tax on the $ Amount.

LAW AND ANALYSIS

I. Code rules

Section 403(b)(8) of the Code provides that if (i) any portion of the balance to the credit of an employee in an annuity contract described in section 403(b)(1) is paid to him in an eligible rollover distribution (within the meaning of section 402(c)(4)), (ii) the employee transfers any portion of the property he receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and (iii) in the case of a distribution of property other than money, the property so transferred consists of the property distributed, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Section 402(c)(8)(B) provides that the term “eligible retirement plan” means (i) an individual retirement account described in section 408(a), (ii) an individual retirement annuity described in section 408(b) (other than an endowment contract), (iii) a qualified trust, (iv) an annuity plan described in section 403(a), (v) an eligible deferred compensation plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), and (vi) an annuity contract described in section 403(b).

Section 894(a)(1) provides that the provisions of the Code shall be applied to any taxpayer with due regard to any treaty obligation of the United States that applies to such taxpayer.

II. Treaty rules

A. Pension distributions

Paragraphs 1 and 2 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support) of the Treaty provide:

1. a) Pensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that State.

b) Notwithstanding sub-paragraph a) of this paragraph, the amount of any such pension or remuneration paid from a pension scheme established in the other Contracting State that would be exempt from taxation in that other State if the beneficial owner were a resident thereof shall be exempt from taxation in the first-mentioned State.

2. Notwithstanding the provisions of paragraph 1 of this Article, a lump-sum payment derived from a pension scheme established in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in the first-mentioned State.

The Treasury Department's Technical Explanation to 17(1) and (2) of the Treaty provides:

Paragraph 1

Paragraph 1 provides as a general rule, in subparagraph (a), that the State of residence of the beneficial owner has the exclusive right to tax pensions and other similar remuneration. For this purpose, a payment is treated as a pension or other similar remuneration if it is a payment under a pension scheme, as defined in sub-paragraph (o) of paragraph 1 of Article 3 (General Definitions). While the term "pension" generally would include both periodic and lump-sum payments, paragraph 2 of the Article provides specific rules to deal with lump-sum payments, so they are not subject to the general rule of paragraph 1.

However, the State of residence, under subparagraph (b), must exempt from tax any amount of such pensions or other similar remuneration that would be exempt from tax in the State in which the pension scheme is established if the recipient were a resident of that State. Thus, for example, a distribution from a U.S. "Roth IRA" to a U.K. resident would be exempt from tax in the United Kingdom to the same extent the distribution would be exempt from tax in the United States if it were distributed to a U.S. resident. The same is true with respect to distributions from a traditional IRA to the extent that the distribution represents a return of nondeductible contributions. Similarly, if the distribution were not subject to tax when it was "rolled over" into another U.S. IRA (but not, for example, to a U.K. pension scheme), then the distribution would be exempt from tax in the United Kingdom.

Paragraph 2

Paragraph 2 is intended to deal with a particular type of double non-taxation that arose under the prior Convention because the United Kingdom does not tax lump-sum distributions from pension funds. Under the prior Convention, a lump-sum payment was treated in the same way as any other pension, and was taxable only in the country of residence of the beneficial owner. Accordingly, a

> person who anticipated receiving a lump-sum distribution from a U.S. pension scheme with respect to employment in the United States could avoid U.S. withholding tax on the distribution by establishing residence in the United Kingdom for the year in which he received the distribution. The person would not be subject to tax in either the United States or the United Kingdom with respect to the lump-sum distribution, resulting in a significant windfall.
>
> Paragraph 2 prevents this unanticipated benefit by providing that, notwithstanding the exclusive residence-country taxation of paragraph 1, any lump-sum payment derived by a resident of a Contracting State from a pension scheme established in the other Contracting State shall be taxable in that other State.

Paragraph 17(2) provides that a lump-sum distribution from a pension scheme will be taxed in the Contracting State where the pension scheme is established, rather than the State of residence. In this case, if the transfer from U.S. Plan to U.K. Plan is treated as a lump-sum distribution from the U.S. Plan to Taxpayer rather than as a tax-free rollover, the distribution will be taxable in the United States, notwithstanding the fact that Taxpayer is a resident of the United Kingdom.

B. Pension schemes [2]

Paragraph 1 of Article 18 (Pension Schemes) of the Treaty provides:

> Where an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension scheme established in the other Contracting State, income earned by the pension scheme may be taxed as income of that individual only when, and, subject to paragraphs 1 and 2 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support) of this Convention, to the extent that, it is paid to, or for the benefit of, that individual from the pension scheme (and not transferred to another pension scheme).

The Treasury Department's Technical Explanation of the Treaty explains that under Article 18(1), a taxpayer's country of residence may not tax the earnings and accretions of a pension scheme established in the other country until such amounts are distributed to the taxpayer:

> Paragraph 1 provides that if a resident of a Contracting State participates in a pension scheme established in the other Contracting State, the State of residence will not tax the income of the pension scheme with respect to that resident until a distribution is made from the pension scheme. Thus, for example,

[2] The term "pension scheme" is defined in paragraph 1(o) of Article 3 (General Definitions) of the Treaty, as amplified by the Exchange of Notes signed on July 24, 2001. U.S. Plan is a pension scheme within the meaning of Article 3(1)(o). We assume U.K. plan also is a pension scheme within the meaning of Article 3(1)(o).

> if a U.S. citizen contributes to a U.S. qualified plan while working in the United States and then establishes residence in the United Kingdom, paragraph 1 prevents the United Kingdom from taxing currently the plan's earnings and accretions with respect to that individual. When the resident receives a distribution from the pension scheme, that distribution may be subject to tax in the State of residence, subject to paragraphs 1 and 2 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support).

Under Article 18(1), the United Kingdom may not tax the earnings and accretions of a U.S. pension scheme with respect to an individual who is a resident of the United Kingdom until such amounts are distributed to such individual.

III. Discussion

The Joint Committee on Taxation Explanation of the Proposed Treaty addresses the meaning of the parenthetical language in Article 18(1) of the Treaty that refers to transfers to another pension scheme:

> The proposed treaty provides that neither country may tax residents on pension income earned through a pension scheme in the other country until such income is distributed. *For purposes of this provision, roll-overs* [sic] *to other pension plans are not treated as distributions.* When a resident receives a distribution from a pension plan, such distribution is generally subject to residency country taxation in accordance with Article 17 (Pension, Social Security, Annuities, Alimony, and Child Support). [Emphasis Added]

The parenthetical language of Article 18(1) of the Treaty merely provides that a transfer of earnings and accretions from one pension scheme to another pension scheme will not be treated as a distribution for purposes of Article 18(1) if the transfer qualifies as a rollover. It does not provide an independent basis for treating a transfer as a tax-deferred rollover distribution; *i.e.*, for U.S. tax purposes, it does not provide an independent basis for treating a transfer as an eligible rollover distribution. To qualify as a tax-deferred rollover distribution, a transfer would have to satisfy the rollover requirements under the domestic laws of both the transferor pension scheme and the transferee pension scheme. A transfer from one pension scheme to another pension scheme established in the same Contracting State would have to satisfy only the rollover requirements under the domestic law of that Contracting State. However, a transfer from a pension scheme established in one Contracting State to a pension scheme in the other Contracting State would have to satisfy the rollover requirements under the domestic law of both Contracting States.

If a U.K. resident were to transfer his account in a U.S. pension scheme to a pension scheme that is an eligible retirement plan described in section 402(c)(8)(B), Article 18(1) of the Treaty would require the United Kingdom to refrain from treating the income earned by the transferor pension scheme as a distribution that is currently subject to

U.K. tax. However, if the U.K. resident were to transfer his account in the U.S. pension scheme to a pension scheme that is not an eligible retirement plan, Article 18(1) would not be applicable, and the transfer of income earned by the transferor pension scheme (together with pre-tax contributions to such pension scheme) would be treated as a taxable distribution that would be subject to the rules of paragraphs 1 and 2 of Article 17.

In Taxpayer's case, the transfer of funds from U.S. Plan to U.K. Plan did not satisfy the rollover requirements under the domestic law of the United States because U.K. Plan is not an eligible retirement plan described in section 402(c)(8)(B).[3] Therefore, Article 18(1) is not applicable, and the transfer is a lump-sum distribution from U.S. Plan to Taxpayer that is taxable in the United States pursuant to Article 17(2).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Lara Banjanin at (202) 622-3880 if you have any further questions.

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[3] Section 402(d) provides that for purposes of section 402(a), (b), and (c), a stock bonus, pension, or profit-sharing trust that would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a). We assume section 402(d) does not apply to U.K. Plan.