



AMERICAN BENEFITS
COUNCIL

October 13, 2016

The Honorable Mark Mazur
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

**Re: Comment on the Impact of Pension Limitation of Benefits Treaty Provisions
on Cross-Border Pension Funds**

Dear Mr. Secretary,

The U.S. Treasury Department recently issued certain revisions to the treatment of pension funds under the U.S. Model Tax Treaty in February, 2016. We wish to comment not on those revisions, but to suggest a further change to address an issue that has begun to be presented in cross-border pension arrangements, primarily in Europe. This suggestion is intended to foreclose the result that aggregating a pension fund in one country for participants and beneficiaries in multiple countries might result in a higher rate of U.S. withholding than would apply if the pension fund were instead separate funds for each country in which the same participants or beneficiaries resided. We believe this suggestion would also bring the U.S. Model Tax Treaty closer in line with the OECD Model Tax Treaty with respect to the residence of pension funds.

Currently, the 2016 U.S. Model Tax Treaty, as with the prior 2006 U.S. model, generally holds that a pension fund established in a Contracting State is a resident of that Contracting State. (Art. 4, Paragraph 2(a).) However, the Limitation on Benefits (“LOB”) provisions in Article 22 of the 2016 U.S. Model Tax Treaty continues to provide that a pension fund that is a resident of a Contracting State is not entitled to the benefits of the treaty otherwise accorded to residents of that Contracting State unless more than 50 percent of the pension fund’s beneficiaries, members or participants are individuals resident in either Contracting State (or, in the case of a fund for multiple pension funds, the earnings of such fund benefit exclusively, or almost exclusively, pension funds that satisfy that requirement). (We note that some treaties, such as the Netherlands and Belgian treaties, alternatively treat a fund as resident if “the organization sponsoring

such person is entitled to the benefits of the Convention pursuant to this Article"; however, this is not in the U.S. model treaty (see Article 22, Paragraph 2(e)), and some countries, such as Belgium, do not require that the sponsoring employer be a resident of Belgium.)

Increasingly, though, pension funds in the European Union (EU) may operate cross-border, and have participants and beneficiaries from multiple EU countries. This has been encouraged by the European Commission's revised Directive on Institutions for Occupational Retirement Provision issued in 2014 and recently revised, known as "IORP II". An example of this can be found with Belgian Organisations for Financing Pensions, or "OFPs." An OFP sponsored by an employer based in Ireland might have a third of its participants in Belgium, a third in the Netherlands, and a third in Ireland, so that the 50% requirement would not appear to be met for the U.S. or Belgium, though if the OFP were three different pension funds, one in each country for the participants and beneficiaries of that country, each fund would gain the benefits of the U.S. tax treaty with that country. (In this example, the Belgian and Netherlands pension funds would pay no U.S. withholding tax on dividends or interest from the U.S. under their respective treaties, while the Irish pension fund would pay 15% withholding on U.S. source dividends, but no U.S. tax on interest.)

This particularly seems an anomalous result given that the Belgian tax treaty (at Paragraphs 9 and 10 of Article 17), extends the pension tax treatment of a U.S. citizen resident in Belgium to an "individual [who] is a member or beneficiary of, or participant in, a pension fund that is a resident of Belgium (*or in a similar fund that is a resident of a comparable third State*)" [emphasis added], and provides for that purpose that other comparable third states include the EU, EEA and NAFTA countries. But that provision only applies for purposes of applying Paragraphs 7 and 9 of Article 17 regarding taxation on distributions for the individual participant or beneficiary, while for the fund's own receipt of dividends, the treaty provides the usual 50% LOB Rule based on Belgium and the U.S. alone. Thus, the U.S. taxpayer resident in Belgium might be treated as participating in a Belgian pension fund, while the fund itself might not be treated as a Belgian fund for tax purposes by reason of having 51% or more of its participants resident in other EU countries.

Under the 2016 U.S. Model Tax Treaty, one manner of addressing this to not disadvantage a cross-border IORP could be for the U.S. to make a determination with respect to certain types of cross-border pension funds under IORP II such as OFPs that "the establishment, acquisition, or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention" and thus qualify for an exception under paragraph 6 of Article 22 of the 2016 U.S. Model Tax Treaty.

Alternatively, the U.S. could choose to apply the 50% LOB rule in the case of treaties between the U.S. and EU countries by counting not only participants and beneficiaries

that are resident of the Contracting States, but those that are residents of “other comparable states” (e.g., EU, EEA and NAFTA countries) as well, or to apply the 50% LOB determination based on participants and beneficiaries who are residents of states which provide the same or lower withholding rate to resident pension funds as that provided to pension funds resident in the Contracting State in question. Another method might be to count plan beneficiaries towards the 50% limit only to the extent that they are beneficiaries under plans resident in other Contracting States but that have been determined by the U.S. to be corresponding plans under the bilateral tax treaty with such other Contracting State. Each of these should ensure that an exception to applying the 50% LOB rule based solely on beneficiaries in the Contracting State that is a party to the treaty in question could not be abused.

This would also have the benefit of coming closer to the OECD model tax treaty, which it was also proposed in February, 2016 clarify that a pension fund should be considered to be a resident of the State in which it is constituted regardless of whether that pension fund benefits from a limited or complete exemption from taxation in that State, but otherwise contains no rule that 50% of the participants and beneficiaries be residents of only one state as a limitation on benefits.

Thank you for your consideration of this comment, and please let us know if you have any questions or if we can be of any assistance.

Respectfully submitted,

A handwritten signature in cursive script that reads "Lynn D. Dudley".

Lynn D. Dudley,
Senior Vice President,
Global Retirement and Compensation Policy
American Benefits Council