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Memorandum

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from: Associate Chief Counsel (International)

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subject: UK Pension Rollovers

This memorandum addresses the possible application of Article 18 (Pension Schemes) of the U.S.-U.K. income tax treaty to a rollover distribution from a U.K. pension scheme to a U.S. retirement plan. This document may not be used or cited as precedent.

ISSUE

Whether an individual who is a resident of the United States may rely on the parenthetical language in Article 18(1) of the U.S.-U.K. income tax treaty[1] (the "Treaty") to make a tax-deferred rollover distribution from a U.K. pension scheme to a U.S. retirement plan in circumstances where the distribution would not qualify as an "eligible rollover distribution" within the meaning of section 402(c)(4).[2]

CONCLUSION

No. Nothing in Article 18(1) of the Treaty overrides the requirement that the distribution must qualify as an "eligible rollover distribution" within the meaning of section 402(c)(4).

FACTS

[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.
[2] All references to "section" are to sections of the Internal Revenue Code of 1986, as amended.

Numerous taxpayers and tax practitioners have asked whether Article 18(1) of the Treaty permits an individual who is a resident of the United States to make a tax-deferred rollover distribution from a U.K. personal pension scheme or other U.K. pension scheme ("U.K. scheme") to a U.S. individual retirement account or other U.S. retirement plan ("U.S. plan") in circumstances where the distribution would not qualify as an "eligible rollover distribution" within the meaning of section 402(c)(4). The question is whether Article 18(1) of the Treaty provides an independent basis for treating the distribution as a rollover distribution that is not currently subject to U.S. tax.

The question typically arises when an individual who has worked in the United Kingdom and participated in a U.K. scheme either returns to the United States or moves to the United States for the first time. In either case, the individual is a resident of the United States within the meaning of Article 4 (Residence) of the Treaty at the time he or she wishes to make the transfer.

LAW AND ANALYSIS

Paragraph 1 of Article 18 (Pension Schemes) provides that:

> 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)*.

[emphasis added]

The Department of Treasury's Technical Explanation of the Treaty explains that under Article 18(1), the taxpayer's country of residence may not tax 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, 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).

Thus, the United States may not tax the earnings and accretions of a U.K. scheme with respect to an individual who is a resident of the United States until such amounts are distributed to the individual.

The Joint Committee on Taxation Explanation of the Proposed Treaty addresses the meaning of the parenthetical language 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 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 (Pensions, Social Security, Annuities, Alimony, and Child Support).

[emphasis added] The parenthetical language 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. To qualify as a rollover, a transfer must satisfy the rollover requirements under the domestic laws of both the transferor pension scheme and 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 established in the other Contracting State would have to satisfy the rollover requirements under the domestic law of both Contracting States.

If a U.S. resident transfers his or her account in a U.K. scheme to another U.K. scheme in accordance with the applicable provisions of U.K. law, Article 18(1) of the Treaty would require the United States to refrain from treating the income earned by the first-mentioned U.K. scheme as a distribution that is currently subject to U.S. tax. However, if the U.S. resident transfers his or her account in the U.K. scheme to a U.S. plan in accordance with the applicable provisions of U.K. law then, because the transfer is not an “eligible rollover distribution” within the meaning of section 402(c)(4), Article 18(1) would not be applicable and the transfer of income earned by the U.K. scheme (together with pre-tax contributions to the U.K. scheme) may be treated as a taxable distribution in the United States.

Note that although Article 17(2) of the Treaty provides that lump-sum distributions derived from a pension scheme established in one country and beneficially owned by a resident of the other country are taxable only in the country where the pension scheme is established, the so-called “saving clause” in paragraph 4 of Article 1 (General Scope) generally allows each country to tax its residents (as determined under Article 4 of the

Treaty) as if the Treaty had not come into effect.[3] Thus, the saving clause would permit the United States to tax a lump-sum distribution to a U.S. resident from a U.K. scheme.

Please call (202) 622-3880 if you have further questions.

[3] There are a number of exceptions to the saving clause in Article 1(5), but there is no exception for the benefits conferred by Article 17(2).