



International Pension & Employee Benefits Lawyers Association

October 24, 2018

Office of the International Tax Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 3058
Washington, DC 20220

Re: Definition of Pension Fund under the 2016 US Model Tax Treaty

Dear Sirs:

This letter is on behalf of the Regulatory Policy Committee of the International Pension and Employee Benefits Lawyers Association (“IPEBLA”) concerning certain changes regarding the definition of a pension fund under the United States (“US”) Model Tax Treaty (the “US Model Tax Treaty”) in 2016.

IPEBLA is an association of approximately 240 pension and benefits lawyers from about two dozen countries around the world organized in 1987 to promote international awareness of the role of law in the provision of pensions and other employee benefits; to promote understanding internationally of the legal relationships between employers, employees and others involved in pensions and other employee benefits plans; and to assist lawyers affecting pension and employee benefits law and design in different countries.

The US Model Treaty Change Background

The prior version of the US Model Tax Treaty issued in 2006 provided that a “pension fund” means any person established in a Contracting State that is: i) generally exempt from income taxation in that State; and “ii) operated principally either: A) to administer or provide pension or retirement benefits; or B) to earn income for the benefit of one or more persons described in clause A.” [emphasis added]

This was changed in the 2016 US Model Tax Treaty so that clause ii) now provides that the pension fund must be “ii) operated exclusively or almost exclusively either: A) to administer or provide pension or retirement benefits; or B) to earn income for the benefit of one or more persons established in the same Contracting State that are generally exempt from income

taxation in that Contracting State and that are operated exclusively or almost exclusively to administer or provide pension or retirement benefits."

The Protocol accompanying the 2016 US Model Tax Treaty describes what constitutes a "pension fund" within the US as follows:

In the case of the United States, the term "pension fund" includes the following: a trust providing pension or retirement benefits under an Internal Revenue Code section 401(a) qualified pension plan (which includes a Code section 401(k) plan) and a profit sharing or stock bonus plan, a Code section 403(a) qualified annuity plan, a Code section 403(b) plan, a trust that is an individual retirement account under Code section 408, a Roth individual retirement account under Code section 408A, a simple retirement account under Code section 408(p), a trust providing pension or retirement benefits under a simplified employee pension plan under Code section 408(k), a trust described in section 457(g) providing pension or retirement benefits under a Code section 457(b) plan, and the Thrift Savings Fund (section 7701(j)). A group trust described in Revenue Ruling 81-100, as amended by Revenue Ruling 2014-24 and Revenue Ruling 2011-1, qualifies as a pension fund only if it is operated exclusively or almost exclusively to earn income for the benefit of pension funds that are themselves entitled to benefits under the Convention as a resident of the United States. [emphasis added]

Examples of Other Benefits Provided by US Pension Funds

We believe that the reference to "exclusively or almost exclusively" administering or providing "pension or retirement benefits" is too narrow.

Even in the US, for example, a tax-qualified pension fund is entitled to provide "incidental benefits", which can include life, health and disability benefits.¹ US tax-qualified plans can also hold funds for retiree medical expenses (e.g., under so-called "401(h) accounts"), provided that the aggregate contributions for medical benefits, when added to actual contributions for life insurance protection under the plan, do not exceed 25% of the total contributions to the plan.² Pension plans can even offer loans to employees³ or in the case of defined contribution plans, make early distributions while still employed in the event of a hardship.⁴ Collective pension trusts in the US, known as "Rev. Rul. 81-100" trusts, which are expressly mentioned in the Protocol accompanying the 2016 US Model Tax Treaty as "pension funds," by definition can include assets of governmental health plans.⁵

¹ US Treasury Regulation section 1.401-1(b)(1). ("A pension plan may provide for the payment of a pension due to disability and may also provide for the payment of incidental death benefits through insurance or otherwise.")

² US Internal Revenue Code section 401(h).

³ US Internal Revenue Code section 72(p).

⁴ US IRS Rev. Rul. 71-224.

⁵ US Internal Revenue Code section 401(a)(24); US IRS Rev. Rul. 2011-1.

We recognize that some comments have already been made that the term “exclusively” is too limited, but we would like to illustrate this concern with the following examples.

Netherlands

Pension funds in the Netherlands are only allowed to provide old-age benefits, disability benefits and survivor's benefits which are agreed between the employer and the employee.

In line with the IORP-directive, pension funds are not allowed to perform activities outside the “pension scope”. However, disability benefits and survivor benefits come within this scope.

Disability benefits under a Dutch pension fund must provide fixed financial benefits to the (former) employee in case of disability after the lapse of the period during which the (former) employee has been entitled to receive sickness benefits under the Sickness Benefit Act (after 24 months). The level of provision of disability benefits depend upon the percentage of disability and are paid in addition to social security disability benefits.

Survivor's benefits include partner pension benefits (fixed or variable financial benefits for the spouse, registered partner or cohabitation partner or the former spouse, registered partner or cohabitation partner) as well as orphan's pension benefits (fixed financial benefits for the child, stepchild or foster child up to a certain age) to be provided after the death of the (former) employee.

The concern would be that limiting a Dutch pension fund to one that “exclusively or almost exclusively” administers or provides pension or retirement benefits could be interpreted to exclude such disability and other survivor’s benefits.

United Kingdom

Section 255 of the Pensions Act 2004 of the United Kingdom generally requires that an occupational pension scheme which has its main administration in the UK must limit its activities to “retirement-benefit activities”. Retirement-benefit activities, in turn, are defined as operations relating to “retirement benefits” and activities arising from operations related to retirement benefits.

“Retirement benefits” are then defined as:

“(a) benefits paid by reference to reaching, or expecting to reach, retirement, and
(b) benefits that are supplementary to benefits in paragraph (a) and that are provided on an ancillary basis -
(i) in the form of payments on death, disability or termination of employment, or
(ii) in the form of support payments or services in case of sickness, poverty or need, or death.”

In addition, Section 150 of the Finance Act 2004 provides that “registered pension schemes”, to be eligible for beneficial tax treatment, provide “benefits to or in respect of persons-

- (a) on retirement,
- (b) on death,
- (c) on having reached a particular age,
- (d) on the onset of serious ill-health or incapacity, or
- (e) in similar circumstances.”

Further, a “registered pension scheme” must, under Section 160 of the Finance Act 2004, make only “authorised member payments” as defined in Section 164 of the Finance Act 2004.

Authorised member payments include, in addition to pensions, lump sums, death benefits, and recognised pension transfers, a variety of other, in general, minor ancillary payments such as compensation for late payment of benefits or the payment of the cost of obtaining financial advice relating to the member’s defined contribution plan retirement benefits of up to £500 from an authorised financial adviser.

Consequently, the terms “exclusively or almost exclusively” and “pension or retirement benefits” would, without clarification, appear to be too tight a test for UK registered pension scheme to pass given the types of “retirement benefits” and payments to and in respect of members which a UK registered pension scheme can make as outlined above.

Belgium

In Belgium, occupational pensions can be organized by two types of pension institutions, namely IORPs (Institutions for Occupational Retirement Provisions, also known as pension funds in the narrow sense); and insurance companies. A “pension fund” within the meaning of the Belgium-US double tax treaty can envisage both IORPs (pension funds in the narrow sense) and insurance companies.

IORPs and Incidental Benefits

The Belgian IORP law transposes the European IORP directive into Belgian law. In accordance with that law, and in line with the IORP Directive, an IORP is an institution which is established for the purpose of distributing work-related “pension distributions”. “Pension distributions” are defined as “distributions paid by reference to reaching, or the expectation of reaching, the pension date, or, when these are supplementary to the distributions and are provided on an ancillary basis, in the form of payments at decease, invalidity, disability or termination of employment, or in the form of supporting payments or services in case of illness, neediness or decease.”

Insurance-Based Benefits

Insurance companies can also provide other benefits in addition to retirement benefits. Nevertheless, in accordance with Belgian law, insurance companies are required to request authorization to exercise activities within a certain “branch”. In principle, authorization is given for the entire “branch”. For example, “branch 21” includes following insurances:

- Life insurances, namely insurances at life, insurances at decease, mixed insurances, life insurances with contra insurance;
- Life annuity insurances;
- Supplementary insurances which are a supplement to a life insurance, namely insurances which cover physical injuries including disability, insurances at decease following an accident and insurances which cover invalidity following an accident or illness.

In other words, in Belgium, pension institutions, whether IORPs or insurance companies, are allowed to provide benefits other than merely pension or retirement benefits. It is common practice that such institutions offer, in addition to occupational pensions, coverages with respect to disability, decease, invalidity, maternity and dependency.

Although these additional benefits are subject to the condition that they be “supplementary” to the retirement benefits, the requirement of “needing to operate exclusively or almost exclusively to administer or provide pension or retirement benefits” to qualify as a “pension fund” in accordance with the double tax treaty concluded with the US, could raise a concern that Belgian pension institutions would fall outside of the scope of the double tax treaty, which certainly should be avoided.

Comparison to the Updated OECD Model Treaty

We would argue that some of these benefits might still be considered similar to retirement or pension benefits, and in some cases these benefits may only be available to retirees, thus arguably making them retirement benefits. In any event, we would urge the US Treasury to clarify in the US Model Tax Treaty that benefits of the nature described do not cause a fund that would otherwise be a “pension fund” to fall outside of that definition. Another solution might look to a recent change in the Model Tax Convention of the Organisation for Economic Cooperation Development (“OECD”).

As part of the Base Erosion/Profit Shifting (BEPS) project report in 2015 and its February 2017 Discussion Draft, the OECD, which maintains its own Model Tax Convention, had similarly proposed to define the term “recognised pension fund” to utilize similar “exclusive” language to the 2016 US Model Treaty (i.e., a pension fund “is constituted and operated exclusively to administer or provide retirement or similar benefits to individuals”). However, in response to concerns expressed about the narrowness of that term, the OECD Model Tax Convention as modified in November, 2017 now provides that a pension fund:

means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State and: (i) that is constituted and operated exclusively or almost exclusively to administer or provide retirement benefits or ancillary or incidental benefits to individuals.... [emphasis added]

The Commentary to the OECD Model Tax Convention at Section 10.13 goes on to provide a non-exclusive list of examples of such ancillary or incidental benefits, including:

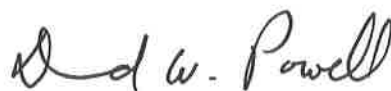
- Death or disability benefits
- Survivor benefits upon death of the participant
- Payments upon terminal illness
- Long-term sickness or unemployment
- Housing benefits, such as preferential loans
- Education benefits
- Financial advice

We believe such a reference to ancillary or incidental benefits being permitted within the US Model Tax Treaty definition of pension fund would be helpful as well.

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We hope that you will be able to give these views some consideration. Please contact David W. Powell of the Groom Law Group, Chartered, in Washington, D.C., Chair of the IPEBLA Regulatory Policy Committee, at 1-202-861-6600 or dwp@groom.com, or Jana Steele, Chair of IPEBLA, at Osler, Hoskin & Harcourt LLP in Toronto, Canada, at 1-416-862-6625 or jsteele@osler.com if you have any questions or if we can be of assistance or provide additional information.

Respectfully submitted,



David W. Powell

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