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GMS Flash Alert

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United States & Switzerland - Competent Authorities Identify Retirement Plans Eligible for Treaty Benefits

On June 7, 2021, the U.S Internal Revenue Service (IRS) published a competent authority arrangement ("CAA") entered into by the competent authorities of the United States and Switzerland.[1] The CAA identifies certain U.S. and Swiss pension or other retirement arrangements, including individual retirement savings plans, that may be eligible for benefits under the "dividends" article of the U.S.-Switzerland income tax treaty.

WHY THIS MATTERS

The U.S.-Switzerland income tax treaty was amended by a protocol, which was signed in 2009 but became effective for most purposes on January 1, 2020.[2] The protocol expanded the scope of the dividends article of the treaty so that it now applies not only to dividends paid to pension and other retirement arrangements, but also to dividends paid to individual retirement savings plans. Thus, for example, a U.S. individual retirement account (IRA) or Roth IRA that invests in a Swiss company can now receive dividends from that company without the imposition of Swiss income tax.

The CAA provides guidance on which pension plans and other retirement arrangements, including individual retirement savings plans, in each country qualify for these treaty benefits.

Context

Prior to the amendments made by the protocol to paragraph 3 of article 10 of the treaty, which relates to dividend income, individual savings plans, such as individual retirement accounts in the United States and contributory private savings plans in Switzerland, were not eligible for the exemption from source-country taxation on dividends conferred under this treaty provision, because these types of plans were not considered pension plans or other retirement arrangements.

Article 1 of the protocol amended this treaty provision by affording individual retirement savings plans the same exemption from source-country taxation on dividends as pension plans and other retirement arrangements.

More Details

Following the amendments made by the protocol, the benefits of paragraph 3 of article 10 of the treaty can be claimed in relation to dividends paid by a company resident in one country provided (1) the dividend is paid to and beneficially owned by a pension or other retirement arrangement that is a resident of the other country, or an individual retirement savings plan set up in and owned by a resident of the other country; (2) the competent authorities of the two countries agree that the pension or retirement arrangement, or individual retirement savings plan, generally corresponds to such a plan or arrangement recognized for tax purposes in the other country; (3) the pension or retirement arrangement, or individual retirement savings plan, does not control the company paying the dividend; and (4) the pension or retirement arrangement, or individual retirement savings plan, satisfies the requirements of the "limitation on benefits" article of the treaty (an anti-treaty shopping provision intended to prevent residents of third countries from obtaining benefits under a treaty).

The CAA provides that the following arrangements meet the second condition – that the competent authorities of the two countries agree that the pension or retirement arrangement, or individual retirement savings plan, generally corresponds to such a plan or arrangement recognized for tax purposes in the other country.

1) Qualified U.S. Pension or Other Retirement Arrangements

a) A trust providing pension or retirement benefits under a U.S. Internal Revenue Code ("Code") section 401(a) qualified pension plan (which includes a Code section 401(k) plan) and a profit sharing or stock bonus plan;

b) A trust described in Code section 457(g) providing pension or retirement benefits under a Code section 457(b) plan;

c) A Code section 403(a) qualified annuity plan and a Code section 403(b) plan;

d) A group trust described in IRS Revenue Ruling 81-100 (as amended by IRS Revenue Ruling 2014-24 and IRS Revenue Ruling 2011-1), provided that it is operated exclusively or almost exclusively to earn income for the benefit of pension funds that are themselves entitled to benefits under the treaty as a resident of the United States;

e) The Thrift Savings Fund (Code section 7701(j)).

2) Qualified U.S. Individual Retirement Savings Plans

a) A trust that is an individual retirement account under Code section 408;

b) A Roth individual retirement account under Code section 408A;

c) A simple retirement account under Code section 408(p); and

d) A trust providing pension or retirement benefits under a simplified employee pension plan under Code section 408(k).

3) Qualified Swiss Pension or Other Retirement Arrangements

a) A Swiss resident pension or other retirement arrangement that has been established in accordance with the federal act on old age, survivors' and disabled persons' insurance payable in respect of employment or self-employment of 25 June 1982, including a retirement arrangement covered by:

i. the Federal Act on Vested Benefits of 17 December 1993;

ii. paragraph 6 and paragraph 7 of Article 89a of the Swiss Civil Code of 10 December 1907; and

iii. any arrangement covered by paragraph 1 of Article 331 of the Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) of 30 March 1911.

4) Qualified Swiss Individual Retirement Savings Plans

a) Any arrangement covered by the federal act on old age, survivors' and disabled persons' insurance payable in respect of employment or self-employment of 25 June 1982, including individual recognized pension plans comparable with occupational pension plans.

The CAA further states that the above list is not exclusive and that other pension arrangements and individual retirement savings plans may apply to the competent authorities of the respective countries to determine if they qualify for the benefits of article 3, paragraph 10 of the treaty.

Upon signature by the U.S. and Swiss competent authorities, the CAA is effective for dividends paid on or after January 1, 2020, and supersedes earlier guidance on this issue provided in IRS Announcement 2005-3.

KPMG NOTE

The CAA only addresses the issue of which pension arrangements and retirement plans qualify for the exemption from source-country tax on dividend distributions under paragraph 3 of article 10 of the treaty and does not address the issue of which pension arrangements and retirement plans qualify for the benefits of paragraph 4 of article 28 of the treaty, which permits individuals working in one of the two countries to deduct or exclude their contributions to a pension or other retirement arrangement established in the other country. The benefits of paragraph 4 of article 28 are subject to certain conditions, including that the competent authority of the country where the individual is working must agree that the pension or other retirement arrangement generally corresponds to a pension or other retirement arrangement recognized for tax purposes in that country.

The CAA does not state that the pension plans and retirement arrangements treated as "generally corresponding" for purposes of paragraph 3 of article 10 also meet this requirement for purposes of paragraph 4 of article 28.

FOOTNOTES:

1 Announcement 2021-11, published on page 1196 of *Internal Revenue Bulletin* 2021-23 (June 7, 2021).

2 For prior coverage, see "Senate Approves Protocol Amending Tax Treaty with Switzerland," in *GMS Flash Alert* (July 17, 2019).

The above information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 as the content of this document is issued for general informational purposes only.

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