

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

CC:INTL:1:ERBarret  
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to: Andrew Zuckerman, Director  
Tony Montanaro, Actuary  
EP Rulings & Agreements, SE:T:EP:RA

from: M. Grace Fleeman, Senior Technical Reviewer, CC:INTL:1  
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subject: [REDACTED] - United States-Canada Income Tax Treaty and the United Nations Joint Staff Pension Fund

This memorandum responds to your request for assistance dated March 7, 2007, regarding the source of distributions from the United Nations Joint Staff Pension Fund (the "UNJSPF") and the impact of the United States-Canada income tax treaty<sup>1</sup> (the "Treaty") on amounts received by a citizen and resident of Canada from the UNJSPF.

**ISSUES**

1. How are distributions from the UNJSPF sourced under U.S. law?
2. How are distributions received by [REDACTED] ("Taxpayer"), a citizen and resident of Canada, from the UNJSPF treated in Canada under Article XVIII(1) of the Treaty?
3. How are distributions received by Taxpayer from the UNJSPF treated in the United States under Article XVIII(2) of the Treaty?

**CONCLUSIONS**

1. The source of UNJSPF distributions under U.S. law is discussed below in connection with the application of Article XVIII(1) and (2) of the Treaty to UNJSPF distributions received by Taxpayer. Under the present facts, the threshold source determination that must be made to determine whether Article

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<sup>1</sup> Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, Signed at Washington on September 26, 1980, as Amended by the Protocols Signed on June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997.

XVIII(1) is applicable to Taxpayer is made under Canadian law. It is our understanding that Canada considers pensions paid from the UNJSPF to arise, in their entirety, in the United States. Canada will thus appropriately apply Article XVIII(1) to determine how it will tax the UNJSPF distributions to Taxpayer.

2. Under Article XVIII(1) of the Treaty, UNJSPF distributions to Taxpayer should be exempt from Canadian taxation to the extent that the distributions would represent a return of Taxpayer's section 72 "investment in the contract" if Taxpayer were a U.S. resident. The source of UNJSPF distributions is not relevant to the determination of Taxpayer's investment in the contract or to the allocation of the investment in the contract to each distribution.
3. Under Article XVIII(2) of the Treaty, determining the U.S. tax treatment of distributions received by Taxpayer from the UNJSPF involves disaggregating each distribution into three components:
  - (1) the investment in the contract,
  - (2) compensation for services (employer contributions), and
  - (3) earnings and accretions.

To the extent that periodic or lump-sum distributions received by Taxpayer from the UNJSPF represent a return of Taxpayer's investment in the contract, they are not subject to U.S. tax.

To the extent that employer contributions are not included in Taxpayer's investment in the contract, the component of periodic or lump-sum distributions received by Taxpayer from the UNJSPF that is attributable to employer contributions with respect to services rendered by Taxpayer must be sourced to determine its U.S. tax treatment. This component is subject to U.S. tax only to the extent that it is from sources within the United States. In general, employer contributions are from sources within the United States to the extent that they are made with respect to services rendered by Taxpayer within the United States. Article XVIII(2)(a) will limit the rate of any U.S. tax to 15 percent in the case of periodic distributions, but there is no Treaty limit on U.S. tax in the case of lump-sum distributions.

The U.S. tax treatment of the component of periodic or lump-sum distributions received by Taxpayer from the UNJSPF that is attributable to earnings and accretions will depend on whether the trust fund for the UNJSPF is (i) a section 401(a) domestic trust or (ii) a foreign trust described in section 402(d).

- If the trust fund for the UNJSPF is a section 401(a) domestic trust, the earnings and accretions component of each periodic or lump-sum distribution received by Taxpayer is U.S. source income subject to U.S. tax. Article

XVIII(2)(a) will limit the rate of U.S. tax to 15 percent in the case of periodic distributions, but there is no Treaty limit on U.S. tax in the case of lump-sum distributions.

- If the trust fund for the UNJSPF is a foreign trust described in section 402(d), the earnings and accretions component of each periodic or lump-sum distribution received by Taxpayer is income from sources without the United States and is not subject to U.S. tax.

## FACTS

[REDACTED] ("Taxpayer") was a citizen and resident of Canada in all relevant periods.<sup>2</sup> Taxpayer worked in Canada for the [REDACTED] ([REDACTED]), an agency of the United Nations, from [REDACTED]. Taxpayer also worked for brief periods in the United States, under a G-4 visa, at the United Nations headquarters in New York. Taxpayer worked in the United States for periods of up to two weeks, and in no year did his presence in the United States exceed ninety days. During the period of his employment with the [REDACTED] Taxpayer contributed \$ [REDACTED] to the United Nations Joint Staff Pension Fund (the "UNJSPF"). During this same period, Taxpayer's employer contributed twice this amount (\$ [REDACTED]) to the UNJSPF on Taxpayer's behalf. Upon his retirement, Taxpayer elected to receive from the UNJSPF a lump-sum payment of \$ [REDACTED] ([REDACTED] percent of the present value of his UNJSPF benefit) (the [REDACTED] lump-sum distribution").<sup>3</sup> Taxpayer started to receive monthly payments of \$ [REDACTED] from the UNJSPF as of [REDACTED].

The materials included with your request for assistance include a letter from the Service dated [REDACTED], indicating a favorable determination with respect to the UNJSPF's status as a qualified plan under section 401(a) of the Internal Revenue Code (the "Code"). You have asked CC:INTL:1 to consider alternative scenarios in which the trust fund for the UNJSPF is (1) a domestic trust,<sup>4</sup> or (2) a foreign trust.<sup>5</sup>

For purposes of this memorandum, we make the following assumptions:

- (1) That the trust fund for the UNJSPF is properly considered a trust for U.S. tax purposes;

<sup>2</sup> It is our understanding that Taxpayer remains a citizen and resident of Canada.

<sup>3</sup> Taxpayer received the lump-sum payment on [REDACTED].

<sup>4</sup> Under rules enacted in 1996, a trust is a domestic trust if (i) a U.S. court is able to exercise primary supervision over the administration of the trust and (ii) one or more U.S. persons have the authority to control all substantial decisions of the trust. See I.R.C. § 7701(a)(30)(E); Treas. Reg. § 301.7701-7(a). Section 401(a) refers to a trust created or organized in the United States. We assume for purposes of this discussion that any trust described in section 401(a) would be treated as a domestic trust under the current definition of "domestic trust."

<sup>5</sup> Under rules enacted in 1996, "foreign trust" means any trust other than a trust described in section 7701(a)(30)(E). I.R.C. § 7701(a)(31)(B). Section 402(d) refers to a trust created or organized outside the United States. We assume for purposes of this discussion that any trust described in section 402(d) would be treated as a foreign trust under the current definition of "foreign trust."

- (2) In the scenario in which the trust fund for the UNJSPF is a domestic trust, that the domestic trust is a qualified trust under section 401(a); and
- (3) In the scenario in which the trust fund for the UNJSPF is a foreign trust, that the foreign trust is a trust described in section 402(d) – that is, a foreign trust properly treated as a trust exempt from tax under section 501(a) for purposes of section 402(a), (b), and (c).

Please note that we express no opinion as to the correctness of these assumptions.

## LAW AND ANALYSIS

### I. **Article XVIII (Pensions and Annuities) of the Treaty**

Article XVIII (Pensions and Annuities) of the Treaty provides in relevant part:

1. Pensions and annuities arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State, but the amount of any such pension that would be excluded from taxable income in the first-mentioned State if the recipient were a resident thereof shall be exempt from taxation in that other State.

2. However:

(a) Pensions may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if a resident of the other Contracting State is the beneficial owner of a periodic pension payment, the tax so charged shall not exceed 15 percent of the gross amount of such payment;

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3. For the purposes of this Convention, the term "pensions" includes any payment under a superannuation, pension, or other retirement arrangement, Armed Forces retirement pay, war veterans pensions and allowances and amounts paid under a sickness, accident or disability plan

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In summary, the Treaty permits Canada to tax its residents on pensions arising in the United States, but Canada may not tax such payments to the extent that they would be excluded from U.S. taxable income if received by a U.S. resident. U.S. source pension payments may also be taxed by the United States, but the tax so charged may not exceed 15 percent of the gross amount of the payment in the case of periodic pension payments beneficially owned by a resident of Canada. If the pension is paid in a lump-sum distribution, there is no Treaty limit on the rate of tax by the source state, meaning

that the source state may tax the distribution at its regular domestic rate. U.S. source pension payments to nonresident alien individuals are generally subject to 30-percent withholding under sections 871(a) and 1441. See Treas. Reg. § 1.1441-4(b)(1)(ii).

## II. Taxation of Pension Distributions under the Code

With respect to payments received by nonresident alien individuals, at the time of a distribution from a section 401(a) plan, the U.S. tax consequences to the employee are determined by disaggregating the distribution into (1) contributions by the employer, which are treated as compensation for services, and (2) the investment return ("earnings and accretions") on the contributions of the employer and employee. See Rev. Rul. 79-388, 1979-2 C.B. 270. See also Rev. Proc. 2004-37, 2004-1 C.B. 1099 (providing a method for determining the source of a pension payment to a nonresident alien from a defined benefit plan where the trust forming part of the plan is a trust created or organized in the United States). Section 871(f) excludes from the gross income of a nonresident alien individual amounts received as an annuity under certain qualified plans but does not appear to be applicable under the present facts.<sup>6</sup>

We believe that a similar analysis should apply with respect to payments received by a nonresident alien individual from a foreign trust described in section 402(d). See Treas. Reg. § 1.402(d)-1(a).<sup>7</sup> Accordingly, the U.S. tax consequences to the employee of a distribution from a foreign trust described in section 402(d) are determined by disaggregating the distribution into (1) contributions by the employer, which are treated as compensation for services, and (2) the investment return ("earnings and accretions") on the contributions of the employer and employee.

### A. U.S. Taxation of Compensation for Services

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<sup>6</sup> Section 871(f)(1) provides:

- (1) **In general.** For purposes of [section 871], gross income does not include any amount received as an annuity under a qualified annuity plan described in section 403(a)(1), or from a qualified trust described in section 401(a) which is exempt from tax under section 501(a), if—
- (A) all of the personal services by reason of which the annuity is payable were either
    - (i) personal services performed outside the United States by an individual who, at the time of performance of such personal services, was a nonresident alien, or
    - (ii) personal services described in section 864(b)(1) performed within the United States by such individual, and
  - (B) at the time the first amount is paid as an annuity under the annuity plan or by the trust, 90 percent or more of the employees for whom contributions or benefits are provided under such annuity plan, or under the plan or plans of which the trust is a part, are citizens or residents of the United States.

We assume for purposes of the present discussion that less than 90 percent of the employees for whom benefits are provided under the UNJSPF are citizens or residents of the United States.

<sup>7</sup> Treas. Reg. § 1.402(d)-1(a) provides in relevant part: "The intent and purpose of section 402(d) is to give those employees, covered under certain non-exempt trusts to which such section applies, essentially the same tax treatment as those covered by trusts described in section 401(a) and exempt under section 501(a), except that the capital gains treatment referred to in section 402(a)(2) does not apply."

Compensation for services performed outside the United States is foreign source income. I.R.C. § 862(a)(3).

Compensation for services performed in the United States is generally U.S. source income. I.R.C. § 861(a)(3).<sup>8</sup>

Compensation for services rendered partly within and partly without the United States is treated as derived partly from sources within and partly from sources without the United States. I.R.C. § 863(b)(1). That part of such compensation that is attributable to services performed within the United States, and that is therefore treated as U.S. source income, is generally determined on a time basis (as defined in Treas. Reg. § 1.861-4(b)(2)(ii)(E)). Treas. Reg. § 1.861-4(b)(2)(ii)(A). Under Treas. Reg. § 1.861-4(b)(2)(ii)(E), the amount of compensation for services performed within the United States determined on a time basis is the amount that bears the same relation to the individual's total compensation as the number of days of performance of the service by the individual within the United States bears to his total number of days of performance of services.

Employer contributions to an annuity or pension plan represent compensation for personal services. See Rev. Proc. 2004-37; Rev. Rul. 79-388 (citing Rev. Rul. 56-82, 1956-1 C.B. 59). Employer contributions to a pension plan with respect to wages earned abroad are compensation for personal services performed without the United States and are treated as foreign source income. See Rev. Proc. 2004-37; Rev. Rul. 79-388 (citing Rev. Rul. 72-149, 1972-1 C.B. 218). U.S. citizens and residents are generally subject to U.S. tax on their worldwide income, including foreign source compensation for services. See generally I.R.C. §§ 1, 61.

In contrast, foreign source income of a nonresident alien individual is subject to U.S. tax only to the extent that such income is effectively connected with the conduct of a trade or business within the United States by the nonresident alien individual. See I.R.C. §§ 861(b), 872(a). Under section 864(c)(4), foreign source income of a nonresident

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<sup>8</sup> Compensation for services performed in the United States is not deemed to be U.S. source income if:

(1) the services are performed by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year,

(2) such compensation does not exceed \$3,000 in the aggregate, and

(3) the compensation is for services performed as an employee of or under a contract with (i) a nonresident alien, foreign partnership, or foreign corporation not engaged in trade or business within the United States, or (ii) an individual U.S. citizen or resident, a domestic partnership, or a domestic corporation, if such services are performed for an office or place of business maintained in a foreign country or in a possession of the of the United States by such individual, partnership, or corporation.

I.R.C. § 861(a)(3). See also Treas. Reg. § 1.861-4(a)(1).

alien individual is treated as effectively connected with the conduct of a trade or business within the United States only if such individual has an office or other fixed place of business within the United States to which such income is attributable and the income is of a type expressly enumerated in section 864(c)(4)(B)(i), (ii), or (iii). Compensation for services is not a type of income enumerated in section 864(c)(4)(B)(i), (ii), or (iii). A nonresident alien individual's foreign source income from services is thus not subject to U.S. tax.

Unless an exception applies – such as the exception in section 864(b)(1)<sup>9</sup> – a nonresident alien who performs personal services in the United States at any time within the taxable year is considered engaged in a trade or business within the United States. I.R.C. § 864(b). U.S. source compensation for services of a nonresident alien engaged in a U.S. trade or business is treated as effectively connected income (ECI) and is subject to U.S. tax on a net basis. See I.R.C. §§ 864(c), 871(b). For taxable years beginning after 1986, section 864(c)(6) provides that when compensation for services of nonresident alien is taken into account in a taxable year other than the taxable year in which the services were performed, the determination whether such income is taxable under section 871(b) (that is, as ECI) is made as if such compensation were taken into account in the taxable year in which the services were performed.<sup>10</sup>

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<sup>9</sup> Section 864(b) provides in relevant part:

(b) **Trade or business within the United States.** For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year but does not include—

(1) **Performance of personal services for foreign employer.** The performance of personal services—

(A) for a nonresident alien individual, foreign partnership, or foreign corporation not engaged in trade or business within the United States, or

(B) for an office or place of business maintained in a foreign country or possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,

by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate \$3,000.

<sup>10</sup> Note that although the ECI portion of a distribution is eligible for net basis taxation under section 871(b), Treas. Reg. § 1.1441-4(b)(1)(ii) requires the withholding agent to withhold as if the entire U.S. source portion of the distribution is subject to gross basis taxation under section 871(a). If Taxpayer performed services at the United Nations headquarters in New York after 1986, he may be entitled to a nominal refund.

## **B. U.S. Taxation of "Earnings and Accretions"**

### **1. Source of Earnings and Accretions**

Section 861(a) of the Code provides that certain items of income are U.S. source income. Section 861(a) does not specify the source of the earnings and accretions component of a distribution by a section 401(a) qualified plan.

When the source of an item of income is not specified by statute or regulation, courts have determined source by comparison and analogy to classes of income specified within the statute. Bank of America v. United States, 680 F.2d 142, 147 (Ct. Cl. 1982); Howkins v. Commissioner, 49 T.C. 689 (1968). In Clayton v. United States, 33 Fed. Cl. 628 (1995), aff'd without published opinion, 91 F.3d 170 (Fed. Cir. 1996), cert. denied, 519 U.S. 1040 (1996), the Court of Federal Claims held that the earnings and accretions component of distributions made by a section 401(a) qualified employee stock ownership plan ("ESOP") to foreign participants was U.S. source income based on the U.S. situs of the trust underlying the ESOP. See also Rev. Rul. 79-388, 1979-2 C.B. 270. Based on Clayton and Revenue Ruling 79-388, the earnings and accretions component of distributions made by a section 401(a) qualified pension plan with an underlying domestic trust (such as the UNJSPF) is U.S. source income.

We believe, consistent with the intent and purpose of section 402(d), that a similar approach should be used to source the earnings and accretions component of distributions made by a foreign trust described in section 402(d). The earnings and accretions component of distributions made by a foreign trust described in section 402(d) should accordingly be treated as foreign source income.

### **2. Taxation of a Nonresident Alien Individual on Earnings and Accretions**

Section 871(a) generally provides that a tax of 30 percent is imposed on an amount received from U.S. sources by a nonresident alien individual as interest, dividends, rents, annuities, and other fixed or determinable annual or periodical gains, profits, and income ("FDAP income"), provided that the amount is not income that is effectively connected with the conduct of a U.S. trade or business. Section 1441 generally provides that all persons having the control, receipt, custody, disposal, or payment of non-ECI items of income specified in section 1441(b) of any nonresident alien individual shall deduct and withhold from such items a tax of 30 percent. The items of income specified in section 1441(b) expressly include FDAP income and annuities.

As noted above, for purposes of the present discussion we assume that the distributions from the UNJSPF are not annuities described in section 871(f). The legislative history to section 871(f) states that, in cases to which section 871(f) does not apply, a nonresident alien receiving pension income from a plan located in the United States is subject to U.S. tax (flat 30-percent or lower treaty rate) on the interest portion of the pension income notwithstanding the fact that the services in respect of which the

employer contributions to the plan were made were entirely rendered outside the United States. See S. Rep. No. 1707, 89<sup>th</sup> Cong., 2d Sess. (1966), 1966-2 C.B. 1059 at 1077.

The 30-percent tax is imposed by section 871(a) only on the amount that constitutes gross income. Treas. Reg. § 1.871-7(a)(2). Section 61(a) generally provides that annuities and income from life insurance and endowment contracts are included in gross income. Section 72 provides rules for determining the portion of certain amounts received under an annuity, endowment, or life insurance contract that is included in gross income.

FDAP income generally includes all U.S. source income included in gross income under section 61, except for gain derived from the sale of property, or any other income that the Internal Revenue Service determines, in published guidance, is not FDAP income. Treas. Reg. §§ 1.871-7(b)(1), 1.1441-2(b)(1)(i), and 1.1441-2(b)(2). Moreover, section 871(a)(1) specifically includes amounts received as annuities as a type of FDAP income. In Barba v. United States, 2 Ct. Cl. 674 (1983), the Claims Court, in determining whether gambling winnings of nonresident alien individuals from U.S. sources were FDAP income, concluded that the words “fixed and determinable annual or periodical gains” should be interpreted broadly to include all classes of income, except income arising from the sale of property. See also Commissioner v. Wodehouse, 337 U.S. 369 (1949).

As noted above, a nonresident alien individual is subject to U.S. tax with respect to foreign source income only to the extent that such foreign source income is effectively connected with the conduct of a trade or business within the United States. Except as provided in section 864(c)(6) or (7) or in section 871(d) or sections 882(d) and (e),<sup>11</sup> in the case of a nonresident alien individual not engaged in trade or business within the United States, no income shall be treated as effectively connected with the conduct of a trade or business within the United States. I.R.C. § 864(c)(1)(B). See also Treas. Reg. §§ 1.864-3, 1.871-1(a)(4). Foreign source income of a nonresident alien individual not engaged in a trade or business within the United States is thus generally not subject to U.S. tax.

### III. DISCUSSION

#### A. Paragraph 1 of Article XVIII

Taxpayer seeks a ruling regarding the U.S. tax treatment of distributions received from the UNJSPF because, under Article XVIII(1) of the Treaty, the Canadian tax treatment of pensions and annuities arising in the United States and received by a resident of Canada will depend in part on how such pensions and annuities would be treated if

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<sup>11</sup> Section 864(c)(6) concerns the treatment of certain deferred payments. Section 864(c)(7) concerns the treatment of certain dispositions of property used in connection with the conduct of a trade or business within the United States. Section 871(d) concerns the election to treat real property income as income effectively connected with the conduct of a trade or business within the United States. Sections 882(d) and (e) concern foreign corporations. None of these sections is relevant to the present discussion.

received by a resident of the United States. Specifically, under Article XVIII(1), Canada may tax its residents on U.S. source pensions and annuities only to the extent that such payments would be included in U.S. taxable income if received by a resident of the United States.

Article XVIII(1) applies only to pensions and annuities arising in one Contracting State and received by a resident of the other Contracting State. As a threshold matter, it is thus necessary to determine whether the amounts received by Taxpayer from the UNJSPF would be sourced in the United States. Under Article III(2) (General Definitions) of the Treaty, Canadian law would apply to make this determination. It is our understanding that Canada considers pensions paid from the UNJSPF to arise, in their entirety, in the United States. Article XVIII(1) will accordingly apply under the present facts to determine how Canada will tax UNJSPF distributions to Taxpayer.

Applying Article XVIII(1), the amount of the UNJSPF distributions that would be excluded from (U.S.) taxable income if Taxpayer were a resident of the United States will be exempt from tax in Canada. Section 72 contains the rules for determining the amount of Taxpayer's investment in the contract, which is the amount that would be excluded from Taxpayer's taxable income if Taxpayer were a resident of the United States. Under the present facts, separate analyses are required to determine the extent to which (1) employee contributions and (2) employer contributions are included in Taxpayer's investment in the contract. This analysis is the same regardless of whether the trust fund for the UNJSPF is a section 401(a) domestic trust or a foreign trust described in section 402(d). See generally I.R.C. §§ 72, 402(a) and (d).

You have asked the Tax Exempt and Government Entities Division (Employee Benefits) for advice regarding the application of section 72(f) and (w) to employee and employer contributions to the UNJSPF on Taxpayer's behalf. We thus do not address the treatment of employee and employer contributions under section 72 in this memorandum.

If Taxpayer were a resident of the United States, distributions to Taxpayer from the UNJSPF would be excluded from Taxpayer's U.S. taxable income to the extent of the investment in the contract allocated to each such distribution.<sup>12</sup> Under Article XVIII(1), distributions to Taxpayer under the UNJSPF should thus be exempt from Canadian taxation to the extent that such distributions would represent a return of Taxpayer's investment in the contract if Taxpayer were a U.S. resident.

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<sup>12</sup> This memorandum does not address the allocation of Taxpayer's investment in the contract to distributions to Taxpayer under the UNJSPF.

**B. Paragraph 2 of Article XVIII**

We next address the application of Article XVIII(2) of the Treaty and the U.S. tax treatment of the amounts received by Taxpayer from the UNJSPF.

**1. Disaggregation of distributions received by Taxpayer under the UNJSPF**

As explained above, we believe, consistent with the intent and purpose of section 402(d), that a similar approach should be used to determine the U.S. tax treatment of UNJSPF distributions to a nonresident alien regardless of whether the trust fund for the UNJSPF is a section 401(a) domestic trust or a foreign trust described in section 402(d). The first step in determining the proper U.S. tax treatment of distributions received by Taxpayer from the UNJSPF is thus to disaggregate the distributions into the following three components:

- (1) Taxpayer's investment in the contract, which is excluded from Taxpayer's gross income for U.S. tax purposes under section 72;<sup>13</sup>
- (2) The part of each distribution that is attributable to employer contributions with respect to services rendered by Taxpayer,<sup>14</sup> which is sourced for U.S. tax purposes as described below; and
- (3) The part of each distribution that represents the earnings and accretions of the UNJSPF—
  - (a) If the trust fund for the UNJSPF is a section 401(a) domestic trust, the earnings and accretions are treated as U.S. source income for U.S. tax purposes, based on the situs of the trust.
  - (b) If the trust fund for the UNJSPF is a foreign trust described in section 402(d), the earnings and accretions are treated as foreign source income for U.S. tax purposes, based on the situs of the trust.

**2. Periodic Distributions Received under the UNJSPF**

Under Article XVIII(2) of the Treaty, the United States may tax U.S. source periodic pension payments at a rate not to exceed 15 percent.

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<sup>13</sup> Because the investment in the contract is expressly excluded from taxable income, its source is not relevant for U.S. tax purposes. We assume, consistent with the advice provided to you by the Tax Exempt and Government Entities Division, that Taxpayer's employee contributions constitute investment in the contract.

<sup>14</sup> This component will only exist to the extent that employer contributions are not included in the investment in the contract.

**a. Disaggregation of distributions: investment in the contract**

To the extent that periodic distributions received by Taxpayer from the UNJSPF represent a return of Taxpayer's investment in the contract, such amounts are not subject to U.S. tax because they are excluded from Taxpayer's gross income for U.S. tax purposes under section 72. Article XVIII(2) of the Treaty does not change this result.

**b. Disaggregation of distributions: employer contributions**

To the extent that employer contributions are not included in Taxpayer's investment in the contract, the component of periodic distributions received by Taxpayer from the UNJSPF that is attributable to contributions by Taxpayer's employer with respect to services rendered by Taxpayer within and without the United States must be sourced to determine its U.S. tax treatment.

Under the present facts, the source of the employer contributions component of UNJSPF distributions would be determined as follows:

1. Determine the amount of employer contributions in a taxable year.
2. Determine the number of days Taxpayer worked in the United States in that taxable year. If Taxpayer did not work in the United States in a particular taxable year, employer contributions made in that taxable year are income from sources without the United States in their entirety.
3. Determine the total number of days Taxpayer worked in that taxable year.
4. The U.S. source portion of employer contributions for that taxable year is determined as follows:

$$\text{U.S. source portion of employer contributions} = \text{employer contributions for taxable year} \times \frac{\text{days worked in United States}}{\text{total days worked in taxable year}}$$

Note, however, that where the U.S. source portion of employer contributions for a taxable year so determined is \$3,000 or less, the employer contributions for that taxable year will generally be considered foreign source in their entirety. See I.R.C. § 861(a)(3); Treas. Reg. § 1.861-4(a)(1).<sup>15</sup>

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<sup>15</sup> Under section 861(a)(3), the relevant services must be performed as an employee of, or under any form of contract with, a "nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States." It is not clear whether services performed as an employee of an international organization such as the [redacted] would be included. A nonresident alien employee of the United Nations would normally not be concerned with satisfying the requirements of

5. Add the amounts determined in Step 4 above to determine the total U.S. source portion of employer contributions for all taxable years.
6. The U.S. source portion of the employer contribution component of each distribution received by Taxpayer is determined by the ratio of the total U.S. source portion of employer contributions for all taxable years to the total employer contributions for all taxable years, that is:

$$\begin{array}{l}
 \text{U.S. source portion} \\
 \text{of employer} \\
 \text{contribution} \\
 \text{component}
 \end{array}
 =
 \begin{array}{l}
 \text{employer} \\
 \text{contribution} \\
 \text{component}
 \end{array}
 \times
 \begin{array}{l}
 \text{Total U.S. source portion of} \\
 \text{employer contributions} \\
 \text{total employer contributions}
 \end{array}$$

Taxpayer, a nonresident alien individual, is not subject to U.S. tax on foreign source income from services, but is subject to U.S. tax on U.S. source income from services. Article XVIII(2) of the Treaty does not change this result. Accordingly, the part of each periodic distribution received by Taxpayer from the UNJSPF that is attributable to employer contributions not included in Taxpayer's investment in the contract is subject to U.S. tax only to the extent that it is U.S. source income.

**c. Disaggregation of distributions: earnings and accretions**

If the trust fund for the UNJSPF is a section 401(a) domestic trust, the part of each periodic distribution received by Taxpayer from the UNJSPF that represents the earnings of the pension plan is income from sources within the United States. Under section 871, such U.S. source amounts received by a nonresident alien individual are subject to U.S. withholding tax. Article XVIII(2)(a) will limit to 15 percent the rate of U.S. withholding on the part of periodic UNJSPF distributions that represents the earnings of the plan. Under paragraph 2 of Article XXIV (Relief from Double Taxation) of the Treaty, Taxpayer will be entitled to deduct the U.S. tax paid from any Canadian tax payable in respect of such amounts, subject to the limits contained in Canada's domestic law.

In contrast, if the trust fund for the UNJSPF is a foreign trust described in section 402(d), we believe that the part of each periodic distribution received by Taxpayer from the UNJSPF that represents the earnings of the pension plan should be treated as income from sources without the United States. As explained above, foreign source income of a nonresident alien individual not engaged in a trade or business within the United States is generally not subject to U.S. tax.

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section 861(a)(3) because his wages would in any case generally be exempt from U.S. tax under section 893.

### 3. The [REDACTED] Lump-Sum Distribution

To the extent that the [REDACTED] lump-sum distribution represents a return of Taxpayer's investment in the contract, this distribution would not have been subject to U.S. tax because it is excluded from Taxpayer's gross income for U.S. tax purposes under section 72. Article XVIII(2) of the Treaty does not change this result.

To the extent that employer contributions are not included in Taxpayer's investment in the contract, the component of the [REDACTED] lump-sum distribution received by Taxpayer that is attributable to employer contributions with respect to services rendered by Taxpayer is subject to U.S. tax only to the extent that it is from sources within the United States. The U.S. source portion of the employer contribution component is determined using the same ratio used for periodic distributions (see the discussion above).

If the trust fund for the UNJSPF is a section 401(a) domestic trust, the part of the [REDACTED] lump-sum distribution that represents earnings and accretions is income from sources within the United States. Under section 871, such a U.S. source amount received by a nonresident alien individual is subject to U.S. withholding tax. In the case of lump-sum pension distributions, Article XVIII(2)(a) will not apply to limit the rate of U.S. withholding on the part of such distributions that represents the earnings of the plan because, by its terms, Article XVIII(2)(a) applies only to "periodic" pension payments. Accordingly, the earnings and accretions component of the [REDACTED] lump-sum distribution would have been subject to U.S. withholding at the full statutory rate of 30 percent.

In contrast, if the trust fund for the UNJSPF is a foreign trust described in section 402(d), we believe that the part of the [REDACTED] lump-sum distribution that represents earnings and accretions should be treated as income from sources without the United States. As explained above, foreign source income of a nonresident alien individual not engaged in a trade or business within the United States is generally not subject to U.S. tax.

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

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