Irish Tax Institute

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Response to OECD Discussion Draft:

The Treaty Residence of Pension Funds

April 2016

About the Irish Tax Institute

The Irish Tax Institute ("the Institute") is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

The Institute welcomes the confirmation that a pension fund will be considered to be a resident of the state in which it is constituted and that the OECD Model Tax Convention ("MTC") will be updated to reflect this.

We set out below comments on the proposed definition of "recognised pension fund" in Article 3(1)(j) of the MTC, specifically addressing questions 2(a) and 2(c) in the discussion draft.

Pension Funds recognised as a Separate Person

There is considerable diversity in the legal structure of pension funds around the world. It is important that the revisions to the MTC are wide enough to ensure that all such pension funds are granted equal entitlement to treaty benefits.

The discussion draft proposes that treaty benefits will only apply to those pension funds that are treated as "separate persons" under the taxation laws of that State. In applying the "separate person" test, the key criterion appears to be that the income in the pension fund is not otherwise attributed to another person for tax purposes.

Not all pension funds are treated as a "separate person" for tax purposes. One such example is an Approved Retirement Fund (ARF), a commonly used investment vehicle in Ireland. An ARF is a Revenue-approved fund in which certain individuals can invest their pension funds on retirement. The income and gains in an ARF accumulate tax-free and an individual is only subject to income tax once drawings are made from the fund (subject to a de-minimis withdrawal being made by the individual each year). For your reference, we have included in the Appendix further details on ARFs as contained in *OECD Reviews of Pensions Systems: Ireland © 2014.* An ARF is just one example of a fund which is not treated as a "separate person".

To ensure that an ARF, and other such pension funds are captured in the revisions to the MTC, we recommend that the definition of *"recognised pension fund"* in Article 3(1)(j) is reworded as follows;

"the term "recognised pension fund" of a State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State <u>or is otherwise approved under the laws of that State, or the trustees of which are resident of that State</u>"

Meaning of 'Similar Benefits'

The definition of "recognised pension fund" in Article 3(1)(j)(i) of the discussion draft refers to a pension fund which provides *"retirement or similar benefits to individuals".*

The commentary provided in paragraph 10.5 of the discussion draft recognises that similar benefits would include payments made as a result of the death of an individual and the Institute welcomes this confirmation. However, for avoidance of doubt, we would suggest that the wording in Article 3 explicitly refers to benefits payable on death. Article 3(1)(j)(i) should be amended as follows;

"that is constituted and operated exclusively to administer or provide retirement <u>or death benefits</u> or similar benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities;

Appendix – Extract from *OECD Reviews of Pensions Systems: Ireland © OECD 2014*

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In addition, there is a specific financial product available for certain people at the point of retirement. People can invest pension savings upon retirement in an Approved Retirement Fund (ARF). Depending on the level of guaranteed pension income available for life and the size of the pension fund, individuals may only have access to a specific type of ARF, called an Approved Minimum Retirement Fund (AMRF). Since 2011, ARFs and AMRFs are available to members of DC occupational plans.

An ARF is an investment contract in which the money is invested with a "Qualifying Fund Manager" (which includes banks, building societies and insurance companies). The individual can decide how to invest the money which accumulates tax-free. Income tax is payable on any money withdrawn from the fund. To invest in an ARF, the individual must have a guaranteed pension income in payment for life from other sources of at least EUR 18 000 annually. Where the minimum specified income test is not met and the individual does not wish to purchase an annuity, the legislation requires that the first EUR 120 000 of the pension fund (after taking the retirement lump sum), or the entire remaining fund, if this is less than that amount, must be invested in an AMRF. The individual may use the AMRF funds at any time to purchase an annuity. When an individual attains the age of 75 or starts receiving a guaranteed pension income for life from other sources of EUR 18 000 a year, the AMRF automatically becomes an ARF. An AMRF is like an ARF except that the individual cannot withdraw the original capital investment. Only the investment income can be withdrawn in the meantime. As explained below [on Page 38], there are incentives for people to withdraw 5% of their ARF fund each year.

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Any money withdrawn from an ARF is taxed at the individual's marginal rate. The Budget and Finance Act 2006 introduced an imputed or notional distribution of 3% of the value of the assets of an ARF on 31 December each year, where the notional amount is taxed at the ARF owner's marginal income tax rate.

The notional distribution measure was introduced to encourage drawdowns from AFRs so that they are used, as intended, to fund a stream of income at retirement. It does not apply to AMRFs. The level of the imputed distribution was increased from 3% to 5% in the Budget and Finance Act 2011, and from 5% to 6% for ARFs with asset values in excess of EUR 2 million in the Budget and Finance Act 2012. The amount of the annual notional distribution is reduced by the amount of actual distributions taken from an ARF and from an associated ARF. In practice, most individuals ensure they withdraw a minimum actual distribution of at least 5% (or 6%) to avoid the notional distribution requirement.