

International assignment perspectives — *special alert*

Income Tax Treaty Update

New developments in tax treaties—particularly double tax relief in the treatment of pension/retirement plans—is the topic of the third article in our series of *International Assignment (IA) Perspectives* special alerts. And to learn about the latest changes we spoke with PwC tax professional, Clarissa Cole (formerly Dougherty), author of the original *IA Perspectives* article, “A close look at income tax treaties.” Since the publication of her article, Ms. Cole told us that three protocols to treaties (introduced by Germany, Finland and Denmark) and one new treaty (introduced by Belgium) entered into force, all effective January 1, 2008. In addition, Canada submitted a proposed protocol. All five countries already have tax treaties with the United States.

Ms. Cole explained that nontaxation of pension contributions and earnings in the host country, when provided under treaty, is generally restricted to the amounts afforded nontaxation/deferral in the host country if made to a host-country plan. These amounts may be much less than those afforded nontaxation/deferral in the home country. When this disparity occurs, the excess amounts may result in double tax, at contribution or earnings date in the host country, and at distribution date in the home country.

To limit double taxation of cross-border pension participation, the United States revised its Model Treaty wording in 2006. The new language allows the assignee to avoid double tax on pension contributions (subject to limitations). It also affords the assignee “automatic” reciprocal treatment, which means that the often lengthy and costly process of obtaining separate competent authority approval (which is often incurred by the employer on behalf of all employees participating in the plan) is avoided. The Model Treaty indicates that relief is not available unless the competent authority of the “host” country has confirmed that the plan generally corresponds to a qualified plan in the host country.

The United States approaches all treaty negotiations with the intent of including the Model Treaty language. But not all countries agree to include it. Cases in point

are Finland and Denmark, whose recent protocols were a disappointment to the United States because neither country adopted language that would provide the desired double tax relief in relation to cross-border pension participation. The German protocol, however, does provide this relief—and it also does not require separate competent authority approval for certain plans. The Belgium treaty, although it contains the relief provision, still requires separate competent authority approval. The Belgium treaty also states that to be eligible for tax relief in the host country, the individual must not have worked in the host country for more than 10 calendar years.

Canada’s proposed protocol, if passed as drafted, will provide relief and will not require separate competent authority approval for certain specified plans. The Canadian proposed protocol states, in part, “contributions made to, or benefits accrued under, a qualifying retirement plan in a contracting state by or on behalf of an individual shall be deductible or excludible in computing the individual’s taxable income in the other contracting state...”

Companies that send their equalized assignees to countries that have adopted the US Model Treaty or similar language may realize a marked reduction in overall equalization costs due to the relief afforded cross-border pension contributions and earnings. The United States continues to make every effort to initiate the process of revising treaties it has with other countries and encourages those countries wishing to do business with the US to adopt the language. Similarly, US companies looking for countries in which to establish hubs for foreign operations will certainly look more favorably on those that have signed treaties that contain the relief.

To learn about measures your company can take to avoid double tax issues with countries that have not adopted the US Model Treaty or similar language, read Ms. Cole’s informative article in the International Assignment Perspectives journal (available for download at <http://www.pwc.com/iaperspectives>).