DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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Reference: Treatment of Lump-Sum Pension Distributions under U.S.-Canada Income Tax Treaty

Dear :

This responds to your letter dated June 25, 2004. In response to your inquiry, we are providing the following general information. This information letter is advisory only and has no binding effect on the Internal Revenue Service.

You have asked about the application of the income tax treaty between the United States and Canada ("Treaty") and the appropriate rate of withholding for a U.S.-source lump-sum retirement payment received by a resident of Canada.

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

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 pension included in income for the purposes of taxation in that other State shall not exceed the amount that would be included in the first-mentioned State if the recipient were a resident thereof.

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 per cent of the gross amount of such payment;

* * *

3. For the purposes of this Convention, the term "pension" 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 * * *

The general rule of paragraph 2(a) is that even though the pension may be taxed by the residence State pursuant to paragraph 1, the pension may also be taxed by the source State according to the laws of that State. In the event the pension payment is "periodic," the tax charged by the source State is limited to 15% of the gross amount of the payment. However, if the pension is paid in a lump-sum distribution, there is no limit on the rate of tax by the source State, meaning that the source State may tax the distribution at its regular domestic rate. Where the United States is the source State, pension distributions are generally subject to 30% withholding under sections 871(a) and 1441. <u>See</u> Treas. Reg. § 1.1441-4(b)(1)(ii).

You asked whether Article XXII (Other Income) might apply in lieu of Article XVIII in the case of a lump-sum pension distribution. Article XXII applies only with respect to items of income not dealt with in the preceding articles of the Treaty. The definition of "pension" provided in paragraph 3 of Article XVIII does not distinguish between periodic payments and lump-sum payments. Therefore, a lump-sum payment that is a "pension" payment within the meaning of paragraph 3 is covered by Article XVIII, although it is not eligible for the 15% rate, and Article XXII has no application. For an example of a qualified plan distribution that was covered by Article XXII instead of Article XVIII because it was a distribution from a stock bonus plan (a terminated ESOP) rather than a pension or annuity, see <u>Clayton v. United States</u>, 33 Fed. Cl. 628 (1995), <u>aff'd. without published opinion</u>, 91 F.3d 170 (Fed. Cir. 1996), <u>cert. denied</u>, 519 U.S. 1040 (1996).

To the extent that, as a result of the application of Article XVIII, the recipient is subject to double taxation, you might consider the effect of Article XXIV (Elimination of Double Taxation).

For additional general information regarding the Treaty, see Publication 597, "Information on the United States-Canada Income Tax Treaty", available on the Internet at http://www.irs.gov/pub/irs-pdf/p597.pdf.

We hope this information will be helpful to you. If you require a definitive determination of the law applicable to your particular facts, you may submit a request for a private letter ruling to this office pursuant to the rules set forth in Revenue Procedure 2004-1, which is available on the Internet at http://www.irs.gov/pub/irs-irbs/irb04-01.pdf. If you

should have any further questions in this matter, please contact
l at (not a toll-free number).

Sincerely,

M. Grace Fleeman
Senior Counsel, Branch 1
Office of Associate Chief Counsel
(International)