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Employees of International Organisations: Pensions Taxation

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Wednesday, April 8th, 2015

When internationally mobile workers retire, they look to Art 18 of the OECD Model tax treaty to determine their tax treatment if they are private sector workers. Government workers look to Art 19. What about employees of international organisations? Although international civil servants, they work for no government and are outside Art 19.

Commonly, treaties that establish international organisations contain rules on the tax treatment of their employees. Thus, for example, the IBRD (World Bank) Articles of Agreement states that:

"No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to executive directors, alternates, officials or employees of the Bank who are not local citizens, local subjects, or other local nationals." (Article VII, Section 9 (b)).

Consequently, World Bank employees at its Washington DC headquarters pay no US tax on their salaries unless they are US citizens. Pensions are not expressly addressed in the IBRD Articles. The World Bank maintains a contributory, defined benefit pension scheme for its employees (the Staff Retirement Plan or "SRP").

Courts in the United Kingdom and Australia have recently considered the taxation of pensions received by former employees of the World Bank. In both cases the pensions were held to benefit from exemption either by relevant double tax treaty (in the UK) or by domestic legislation that was construed in conformity with the World Bank Articles of Agreement (in Australia).

World Bank Group employees who retire to the UK were held to qualify for exemption from UK income tax on their pensions under art 17(1)(b) of the US-UK double tax treaty in *Macklin v HM Revenue and Customs* [2015] UKUT 39. Art 17(1)(a) of that treaty corresponds to art 18 of the OECD Model, by allocating exclusive taxing rights over pensions to the recipient's residence state. However, art 17(1)(b) requires pensions paid from a pension scheme established in the other contracting state that would be exempt from taxation in that state if the beneficial owner were resident there, also to be exempt from taxation in the residence state. Under US domestic law, non-US citizens resident in the US are exempt on World Bank pensions to the extent of employer and employee contributions (as required by the IBRD Articles). The pivotal issue in the case was whether the SRP was "a pension scheme established in the [US]".

World Bank Staff Retirement Plan

In coming to this conclusion, the UK Upper Tribunal (Tax and Chancery) over-ruled the First-Tier

Tribunal and found that the SRP is a pension scheme established in the US within the definition in art 3(1)(o) of the treaty.

The term “pension scheme” is defined as:
“any plan, scheme, fund, trust or other arrangement established in a Contracting State which is:
(i) generally exempt from income taxation in that State; and
(ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements”.

The SRP was set up and is fully managed and administered by the World Bank at its headquarters in Washington DC. A ruling from the IRS confirms that the SRP largely conforms with US pension plan tax rules, except that it is not “created or organized in the US” because it is not a US domestic trust. It is administered in conformity with US tax rules for qualifying pension plans. The Upper Tribunal rejected the HMRC contention that only a pension plan that meets all US tax rules on pension plans can be “established in” the US.

The Upper Tribunal also rejected the HMRC contention that the SRP was not “generally exempt from income tax” in the US because it was exempt under immunities from tax contained in the treaty establishing the World Bank as an international organisation (IBRD Articles, Article VII, Section 9 (b)), rather than under the US tax rules on pension plans. The Upper Tribunal ruled that these terms in the US-UK tax treaty must be given their ordinary meaning in context, and in light of the object of the treaty, as required by art 31(1) of the Vienna Convention on the Law of Treaties.

Both the definition of “pension scheme” and the exemption required in the residence state of pension recipients are contained in the US Model income tax treaty (2006) and in many treaties concluded by the US in the 21st Century.

“Emoluments”

In *Macoun v Commissioner of Taxation* [2014] AATA 155, the Australian Administrative Appeals Tribunal held that a World Bank pension received by an Australian resident is exempt from income tax. There the exemption was by reason of the Australian International Organisation (Privileges and Immunities) Act 1963 which extended exemption to salaries and emoluments received from a prescribed organisation, which included the World Bank.

There the Tribunal ruled that the pension payments are in the nature of an “emolument” because they can be described as a profit or gain arising from an office or employment or as “compensation for services” by way of remuneration. The relevant entitlement arose during the employment and it did not matter that some part was to be paid after employment ceased.

Although the Tribunal did not explicitly refer to the expression “salaries and emoluments” in the IBRD Articles, it is clear that the Tribunal recognised the need for domestic law designed to implement a treaty to be interpreted so as to give effect to the purpose of the treaty.

The Tribunal considered that the pension benefits were clearly part of an overall remuneration package which could be expected to provide a strong incentive, especially given the personal inconveniences and disruption consequent on taking up a regular position with an international organisation overseas. The purpose of the immunities is to enable the organisation to perform its functions, so as to attract personnel with exceptional experience and qualifications to best serve the

organisation.

The inclusion of pension payments in the term emoluments was held to be in line with the ordinary meaning to be given to the terms of the treaty (the IBRD Articles) in their context and in light of the treaty's object and purpose under art 31(1) VCLT, and, consistent with the language used, having regard to the context, object and purpose of the domestic statute.

The Tribunal also referred to the Superior Court of Justice of Catalonia, decision number 326 /2007, dated March 28 2007 which ruled that pensions paid after cessation of office and employment as a United Nations official were exempt from taxation as being "emoluments".(See Schwarz on Tax Treaties 3rd Edition (CCH) Chapter 2 para 10-175 on the exemption for UN employees)

[Jonathan Schwarz was counsel for the taxpayer in Macklin v HM Revenue and Customs at the First-tier and Upper Tribunal.]

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