Malta Pension Plan Has IRS's Attention—Are You Compliant?

By Eli Noff, Esq., CPA, Partner, Mary Lundstedt, Esq., Associate

On July 1, 2021, the IRS concluded its annual "Dirty Dozen" list and concurrently issued a warning to taxpayers to watch out for potential tax scams. Significantly, in its "wrap up," the IRS especially highlighted Maltese pension plans as belonging to the group identified as "aggressively marketed abusive arrangements." According to the IRS:

> Some U.S. citizens and residents are relying on an interpretation of the U.S.-Malta Income Tax Treaty (Treaty) to take the position that they may contribute appreciated property tax-free to certain Maltese pension plans and that there are also no tax consequences when the plan sells the assets and distributes proceeds to the U.S. taxpayer. Ordinarily gain would be recognized upon disposition of the plan's assets and distributions of the proceeds. The IRS is evaluating the issue to determine the validity of these arrangements and whether Treaty benefits should be available in such instances and may challenge the associated tax treatment.

Apparently, this perceived threat was sufficient to motivate a relatively rapid response, because less than six months later, the United States and the Republic of Malta entered a Competent Authority Agreement (CAA) regarding the definition of the term "pension fund." The CAA stated that:

> It has come to the attention of the competent authorities that U.S. citizens and residents are establishing personal retirement schemes in Malta under the Retirement Pensions Act of 2011 with no limitation based on earnings from employment or self-employment, and are making contributions to these schemes in forms other than cash (e.g., securities). Questions have arisen in the United States about whether these personal retirement schemes are "pension funds" for purposes of applying the Treaty.

Exercising its authority under paragraph 3 of Article 25 of the United States-Malta income tax treaty (Treaty), the competent authorities mutually agreed that, for purposes, of the Treaty, the term "pension fund" excludes funds which:

1. are allowed to accept contributions from a participant in a form other than cash; or
2. do not limit contributions by reference to earned income from personal services (including self-employment) of the participant or the participant's spouse.

Thus, according to the CAA, if the fund fails to satisfy either of those two prongs, treaty benefits no longer apply. Note that, since Maltese personal retirement schemes fail this definition, "they are not properly treated as a pension fund for Treaty purposes and distributions from these schemes are not pensions or other similar remuneration."

What Should You Do? Act Quickly!

Some promoters selling "Malta pension plans" sold them under the pretense that it was a legitimate means of deferring or eliminating federal income taxes. If you have a Malta pension plan, consider carefully the IRS's December warning:

> The IRS is actively examining taxpayers who have set up these arrangements and recognizes that other taxpayers may have filed tax returns claiming Treaty benefits as a result of their participation in these arrangements. These taxpayers should consult an independent tax advisor prior to filing their 2021 tax returns and take appropriate corrective actions on prior filings.

We urge you to consult a tax professional to determine whether or not your arrangement is covered by the Treaty definition of "pension fund." If it is not, acting quickly to get compliant is KEY. We can work with you to take all corrective actions, as necessary. Contact Eli Noff at (410) 497-5947 or schedule a confidential consultation with our brief contact form.

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