This technical query paper was submitted to Revenue on 28 February 2023 via the TALC Direct/Capital Taxes sub-committee following the February 2023 TALC Direct/Capital Taxes sub-committee meeting.

This technical query paper is in response to Revenue's position paper on the tax treatment of foreign pension lump sum amounts which are paid to individuals who are resident in the State for tax purposes, that was included as an addendum to the Minutes of the TALC Direct/Capital Taxes sub-committee meeting of 1 September 2022.

Revenue's position paper was in response to the Institute's original technical query paper submitted to Revenue in August 2021 which sought clarification regarding the basis of taxation on the commutation of a foreign pension which accumulated from contributions out of foreign income. The August 2021 technical query paper was discussed at meetings of the TALC Direct/Capital Taxes sub-committee from September 2021 to December 2022. The discussions are reflected in the Minutes.

Revenue provided a written response to this technical query paper on 8 May 2023 and the response is included below as an appendix.

ITI submission to Revenue on the tax treatment of foreign pension lump sums received prior to 1 January 2023

28 February 2023

Introduction

On 27 August 2021, the Institute made a submission to Revenue seeking clarification regarding the basis of taxation on the commutation of a foreign pension which accumulated from contributions out of foreign income.

In response, Revenue set out their view that the receipt of a lump sum from a foreign pension is a taxable source of income which is liable to income tax and universal social charge under Case III of Schedule D. This is on the basis that Revenue's view is that a lump sum is income from a foreign security and possession in accordance with section 18(2) of the Taxes Consolidation Act 1997 (TCA 1997). Revenue's paper is included as an Addendum to the Minutes of the September 2022 meeting of the TALC Direct/Capital Taxes Sub-committee.

Finance Act 2022 introduced legislation that provides that foreign pension lump sums received on or after 1 January 2023 are to be subject to a new taxation regime which will treat them in a manner consistent with Irish lump sums.

In this submission, we have set out the basis for the Institute's view that a lump sum from a foreign pension (arising before 1 January 2023) is a capital payment and thus not a taxable source of income under Case III of Schedule D.

Legislative approach

Section 18(2) TCA 1997 provides that income from foreign securities and possessions charged under Schedule D Case III includes the profits or gains arising from any kind of property, that is, from everything the person possesses that is a source of income, other than a source situated within the State.

It is clear that for section 18(2) to apply there must be a source of income. In determining the definition of income, the following sections are relevant.

Section 2 TCA 1997 states:

"a source of income is within the charge to corporation tax or income tax if that tax is chargeable on the income arising from it, or would be so chargeable if there were any such income, and references to a person, or to income, being within the charge to tax, shall be similarly construed".

Section 3 TCA 1997 provides that 'chargeable tax' means:

"in relation to an individual for a year of assessment, the amount of income tax to which that individual is chargeable for that year of assessment under section 15 in respect of his or her total income for that year…".

Income tax is a tax on income, it is not a tax on capital. If Revenue's interpretation were correct, then a foreign pension lump sum is a source of income and not a source of capital. We would not agree with such an interpretation.

In order for foreign pension lump sums to be taxable under section 18(2), the payments must be regarded as income. However, in our view a foreign pension lump sum is not a payment of income and in fact is capital in nature.

A pension lump sum arises where there is a commutation of future pension rights. We consider that this commutation is capital in nature and thus is not within the remit of section 18(2).

The word 'income' does not have a specific statutory definition within TCA 1997. The House of Lords has held (in the context of there also being no statutory definition of income in the UK tax code) that the word income is to be understood as having the ordinary meaning ascribed to it. In *Lord Chetwode v Inland Revenue Comrs*, Viscount Dilhorne stated:

"Income is an ordinary word in the English language and, unless the context otherwise requires, it should be given its ordinary natural meaning in a statute".

In Black's Law Dictionary, income is defined as *"the money or other form of payment that one receives, usu. periodically, from employment business, investments, royalties, gifts and the like".*

It can be seen that 'income' is an umbrella term which encompasses any receipt/payment which is 'income/revenue' in nature (as distinct from 'capital' in nature), and which is from a source. A foreign pension lump sum is not a periodic payment. It is a once off withdrawal of accumulated pension contributions.

It is also important to highlight Revenue's long-standing practice that where an individual moves to Ireland having been non-resident and non-ordinarily resident, funds accumulated from income earned abroad prior to 1 January in the year the individual becomes Irish resident will not be liable to income tax even if remitted after that date. Our view is that a foreign pension is also an accumulation of funds which should be deemed capital if the accumulation occurred whilst the individual was non-resident and non-ordinarily resident.

Historical Position

Prior to the introduction of Section 790AA *(*dealing with the taxation of pension lump sums in excess of the tax-free amount*)* into TCA 1997, pension lump sums were not subject to Irish income tax. There was no specific exemption for the lump sum from income tax as it was considered a capital receipt.

There is a capital gains tax (CGT) exemption for pension lump sums (capital payments from superannuation schemes) contained in section 613(3) TCA 1997 which exempts a lump sum from CGT. The fact that the legislature deemed it necessary to provide for a specific statutory exemption from CGT implies that in the absence of such exemption, it would be subject to CGT.

Precedent 28, which was originally published in 1987, confirmed Revenue's view that lump sums in commutation of foreign pensions were not taxable in Ireland should the individual come to reside in the country following their retirement. In effect, the precedent was verifying that the tax treatment of foreign pension lump sums should follow the same treatment as Irish pension lump sums. In our view, Precedent 28 only confirmed what was the correct technical interpretation, i.e., the pension lump sum was a capital receipt and was exempted from CGT by virtue of section 613(3) TCA 1997.

Position post Section 790AA

Section 790AA TCA 1997 was introduced on 7 December 2005 and imposed a maximum limit on the tax-free lump sum payable from a pension plan for the first time. This section only applies to *"relevant pension arrangements"* which is effectively all Irish Revenue-approved pension arrangements (including PRSAs, RACs and Personal Retirement Bonds) and any foreign pension scheme where the individual has claimed migrant member relief. The new regime only applied to lump sums received on or after 7 December 2005 as pension lump sums received prior to that date were not subject to income tax, as per the historical position.

Section 790AA did not change how the pension lump sum was calculated (i.e., up to 1.5X remuneration or 25% of the fund where relevant) but instead imposed a new taxation regime for amounts above 25% of the Standard Fund Threshold ("SFT"). Under the new regime amounts above 25% of the SFT from relevant pension arrangements were treated as income and taxable under the PAYE system.

Section 790AA was amended with effect from January 2011 which limited tax free amounts to €200,000 and introduced a 20% tax rate on the balance up to the 25% of the SFT. The amount of the lump sum taxable at 20% is not reckoned in computing total income for the purposes of the Taxes Acts.

Conclusion - foreign pension lump sums

Neither section 790AA nor any subsequent amendment to this section treat lump sums from pension arrangements which are not relevant pension arrangements as income and therefore we consider that the historical position prevails in respect of these pension lump sums.

Section 200A has now introduced rules for foreign pension lump sums similar to those introduced in section 790AA. Section 200A applies to foreign pension lump sums received on or after 1 January 2023 and there is no reason to believe that the introduction of section 200A retrospectively applies to lump sums received prior to the introduction of this section. Indeed, such an interpretation would be

inconsistent with how the changes were applied with the introduction of section 790AA.

It is our firm view that in cases where foreign pension lump sums were received prior to 1 January 2023 the historical position should apply consistent with Precedent 28.

Appendix I: Response received from Revenue on 8 May 2023 to the Institute's February 2023 submission on the tax treatment of foreign pension lump sums received prior to 1 January 2023

TALC subgroup on the treatment of foreign pension lump sum payments

1. Background

On 27 August 2021, the Irish Tax Institute made a submission to Revenue seeking clarification regarding the basis of taxation on the commutation of a foreign pension which accumulated from contributions out of foreign income. A detailed response was provided to the Irish Tax Institute, in which we confirm section 18(2) of the TCA 1997, income from foreign securities and possessions are charged to tax under Case III of Schedule D.

On 28 February 2023, the Irish Tax Institute responded confirming that in their view a pension lump sum arises where there is a commutation of future pension rights and that this commutation is capital in nature and thus is not within the remit of section 18(2).

Below outlines Revenue´s response to the analysis of the interpretation put forward.

2. Section 18

2.1 ITI submission:

Section 18(2) TCA 1997 provides that income from foreign securities and possessions charged under Schedule D Case III includes the profits or gains arising from any kind of property, that is, from everything the person possesses that is a source of income, other than a source situated within the State.

It is clear, that for section 18(2) to apply there must be a source of income. In determining the definition of income, the following sections are relevant.

<u>Section 2 TCA 1997 states</u>:

"a source of income is within the charge to corporation tax or income tax if that tax is chargeable on the income arising from it or would be so chargeable if there were any such income, and references to a person, or to income, being within the charge to tax, shall be similarly construed".

<u>Section 3 TCA 1997 provides</u> that 'chargeable tax' means: in relation to an individual for a year of assessment, the amount of income tax to which that individual is chargeable for that year of assessment under section 15 in respect of his or her total income for that year…".

Income tax is a tax on income, it is not a tax on capital. If Revenue's interpretation were correct, then a foreign pension lump sum is a source of income and not a source of capital. We would not agree with such an interpretation.

In order for foreign pension lump sums to be taxable under section 18(2), the payments must be regarded as income. However, in our view a foreign pension lump sum is not a payment of income and in fact is capital in nature.

A pension lump sum arises where there is a commutation of future pension rights. We consider that this commutation is capital in nature and thus is not within the remit of section 18(2).

2.2 Revenue response:

Section 18(2) of the TCA 1997 provides that income from foreign securities and possessions are charged to tax under Case III of Schedule D. Between them, headings (e) and (f) of section 18(2) charge to tax all forms of income from foreign sources, notwithstanding that such income is of a type which would, if it arose within the State, be taxable under a different case or Schedule.

The ITI submission states that for section 18(2) to apply, "*there must be a source of income*". This is not explicitly stated in section 18(2), which instead provides that tax shall be charged under Case III of Schedule D on *"income arising from possessions outside the State*" (per paragraph (f), with emphasis added).

As outlined in our November 2022 analysis, this is to be interpreted *"in the widest sense possible as denoting everything that a person has a source of income"* (**Colquhoun v Brooks** 2 TC 490). This includes a foreign pension arrangement from which the foreign lump sum amount is paid.

With respect to the reference to section 2, this section gives the meaning of certain terms and sets out rules for the construction of certain references used in the Tax Acts. The section provides for the construction of the terms "a source of income is within the charge to income tax or corporation tax", "a person being within the charge to tax" and "income being within the charge to tax". Where these terms occur in the Tax Acts they are to be taken as meaning that income tax or corporation tax, as appropriate, is chargeable on the income arising from the source, or is chargeable on the person, or is chargeable on the income. It should be noted that the term "*source of income*" is not actually referenced in section 18(2), which instead uses the term "*possession*".

3. Commutation of pension rights

3.1 ITI submission:

A pension lump sum arises where there is a commutation of future pension rights. We consider that this commutation is capital in nature and thus is not within the remit of section 18(2).

3.2 Revenue response

For pension purposes, a commutation is a replacement of a series of future pension payments by an immediate lump sum. As stated in our November 2022 analysis, the fact that a taxpayer has chosen to commute the pension in place of an immediate lump sum payment does not change the fact that the payment of the lump sum payment is considered to be income of the taxpayer as it still arises from the foreign possession, i.e., the foreign pension arrangement.

4. The word "income"

4.1 ITI submission:

The word 'income' does not have a specific statutory definition within TCA 1997. The House of Lords has held (in the context of there also being no statutory definition of income in the UK tax code) that the word income is to be understood as having the ordinary meaning ascribed to it. In Lord Chetwode v Inland Revenue Comrs, Viscount Dilhorne stated:

"Income is an ordinary word in the English language and, unless the context otherwise requires, it should be given

its ordinary natural meaning in a statute".

In Black's Law Dictionary, income is defined as "the money or other form of payment that one receives, usu. periodically, from employment business, investments, royalties, gifts and the like".

It can be seen that 'income', is an umbrella term which encompasses any receipt/payment which is 'income/revenue' in nature (as distinct from 'capital' in nature), and which is from a source. A foreign pension lump sum is not a periodic payment. It is a once off withdrawal of accumulated pension contributions.

4.2 Revenue response:

A pension fund is a plan, fund or scheme that provides retirement income, some of which may be taken as a lump sum payment.

Notwithstanding that a pension lump sum is not a periodic payment, it remains a payment of income from a foreign possession. The use of "usu. periodically" in the quote from Black's Law Dictionary provides that there is no requirement for a payment to be made periodically for it to be considered "income".

For example, a once-off payment may constitute an emolument of employment even it is paid otherwise than by way of remuneration for employment services (Shilton v Wilmhurst [1991] 2 W.L.R 530).

5. Revenue practice - Accumulation of funds prior to becoming Irish Resident

5.1 ITI submission:

It is also important to highlight Revenue's long-standing practice that where an individual moves to Ireland having been non-resident and non-ordinarily resident, funds accumulated from income earned abroad prior to 1 January in the year the individual becomes Irish resident will not be liable to income tax even if remitted after that date. Our view is that a foreign pension is also an accumulation of funds which should be deemed capital if the accumulation occurred whilst the individual was non-resident and non-ordinarily resident.

5.2 Revenue response:

It is Revenue's long-standing practice that where an individual moves to Ireland having been nonresident and non-ordinarily resident, funds accumulated from income earned abroad prior to 1 January in the year the individual becomes Irish resident will not be liable to income tax even if remitted after that date. This practice is concessionary in nature and applies only to income which was paid to a taxpayer from a foreign source (e.g. foreign rental property) prior to becoming resident here.

Revenue do not apply this principle to overseas pensions which are paid to an Irish resident taxpayer, as stated in our earlier correspondence, for the following reasons:

- The practice, which is concessionary in nature, applies only to income which was paid to a taxpayer from a foreign source (e.g. foreign rental property) prior to becoming resident here.
  This is different to a case where a taxpayer is paid a pension from an overseas pension plan while resident. In such cases, the taxpayer is taking a payment from a "new" source of income (the foreign pension fund), which as it arises from a foreign possession, is chargeable to tax under Case III of Schedule D.

- Section 200 TCA 1997 provides for a tax exemption for certain foreign occupational and social security pensions, in cases where these pensions are disregarded for income tax purposes in the hands of a

resident of the country of source. The section was introduced into law in the Finance (Miscellaneous Provisions) Act 1968. The section was introduced to attract US citizens, with non-taxable US pension plans, to come to live in the State.

The section provides for the exemption of the qualifying pension from Irish tax by deeming it to fall outside the provisions of section 18(2) TCA 1997. This is an implicit acknowledgement that section 18(2) TCA 1997 charges foreign pension payments to tax, notwithstanding that the pension fund may have been in existence prior to an individual coming to the State to take up residence here.

With respect to a foreign pension representing an accumulation of funds prior to becoming resident, this may not be considered to apply to individuals who are members of defined benefit type schemes, which provide pension benefits (lump sums or pensions) which are determined by length of service. In such cases, there is no accumulation of funds prior to becoming resident here.

6. Historical Position

6.1 ITI submission:

Prior to the introduction of Section 790AA (dealing with the taxation of pension lump sums in excess of the tax-free amount) into TCA 1997, pension lump sums were not subject to Irish income tax. There was no specific exemption for the lump sum from income tax as it was considered a capital receipt.

Precedent 28, which was originally published in 1987, confirmed Revenue's view that lump sums in commutation of foreign pensions were not taxable in Ireland should the individual come to reside in the country following their retirement. In effect, the precedent was verifying that the tax treatment of foreign pension lump sums should follow the same treatment as Irish pension lump sums. In our view, Precedent 28 only confirmed what was the correct technical interpretation, i.e., the pension lump sum was a capital receipt and was exempted from CGT by virtue of section 613(3) TCA 1997.

6.2 Revenue response:

Section 790AA TCA 1997 was originally inserted into the TCA by section 14(1)(f) Finance Act 2006. The regime under the 2006 measure (the "original regime"), which applied to retirement lump sums paid from 7 December 2005 to 31 December 2010, provided that the amount by which such a lump sum exceeded 25% of the prevailing standard fund threshold (SFT) was to be treated as emoluments in the hands of the individual in the year of assessment in which it was paid and was subject to tax, under Schedule E, at the individual's marginal rate of tax in that year.

Prior to this amendment there was no absolute monetary cap on the amount of tax-relieved pension savings that can be built up in a pension fund and therefore no absolute cap on the amount that can be taken as a lump sum from a pension, totally tax-free. The Minister stated: "*Tax equity would dictate that there should be a limit on the extent to which the Exchequer should be expected to fund savings towards an individual's retirement through the tax system and, as part of that, towards the provision of a tax-free lump sum".* It was proposed and brought into law, therefore, to apply an absolute cap of €1,250,000 on the tax-free lump sum from a pension taken on, or after, 7 December 2005.

7. Section 613(3)(a) TCA 1997

7.1 ITI submission

There is a capital gains tax (CGT) exemption for pension lump sums (capital payments from superannuation schemes) contained in section 613(3) TCA 1997 which exempts a lump sum from CGT. The fact that the legislature deemed it necessary to provide for a specific statutory exemption from CGT implies that in the absence of such exemption, it would be subject to CGT.

7.2 Revenue response:

Section 613(3)(a) TCA 1997 provides the following:

> *(3) No chargeable gain shall accrue on the disposal of a right to or to any part of—*
>
> *(a) any allowance, annuity or capital sum payable out of any superannuation fund, or under any superannuation scheme, established solely or mainly for persons employed in a profession, trade, undertaking or employment, and their dependants,"*

This applies to scenarios where an individual disposes of a right to or any part of an "*allowance, annuity or capital sum"* payable out of a superannuation fund/scheme.

8. Conclusion - foreign pension lump sums

8.1 ITI submission:

Neither section 790AA nor any subsequent amendment to this section treat lump sums from pension arrangements which are not relevant pension arrangements as income and therefore we consider that the historical position prevails in respect of these pension lump sums.

Section 200A has now introduced rules for foreign pension lump sums similar to those introduced in section 790AA. Section 200A applies to foreign pension lump sums received on or after 1 January 2023 and there is no reason to believe that the introduction of section 200A retrospectively applies to lump sums received prior to the introduction of this section. Indeed, such an interpretation would be inconsistent with how the changes were applied with the introduction of section 790AA.

It is our firm view that in cases where foreign pension lump sums were received prior to 1 January 2023 the historical position should apply consistent with Precedent 28.

8.2 Revenue response:

In common with most precedents over five years old, the benefits associated with the Precedent 28 are no longer available.

Section 200A Taxes Consolidation Act 1997 (TCA 1997) is a new section inserted into the TCA 1997 by section 19 Finance Act 2022, to align the treatment of domestic and foreign pension lump sum payments. The section provides that lump sum payments from foreign pension arrangements can also benefit from the same tax-free threshold and tax treatment as domestic pension arrangement, given that lump sum payments from these schemes are not covered under existing pension lump sum rules (s.790AA TCA 1997). In the absence of such a provision, the payment of a lump sum from a pension arrangement which is not covered under s.790AA is fully taxable, with no tax-free limits.

However, while section 200A does not apply retrospectively, Revenue is prepared to allow taxpayers to claim the benefit of the section with respect to lump sum payments drawn down from foreign pension arrangements prior to 1 January 2023.