



CLIENT BRIEFING • INTERNATIONAL TAX

Foreign Pension and Annuity Distributions

What clients receiving retirement income from abroad need to know before they file

Clients who worked or lived abroad often come home with a foreign pension, a retirement annuity, or a foreign social security benefit already in pay status. The U.S. tax answer for that income is rarely the domestic-pension answer, because a treaty may reallocate taxing rights, a saving clause may pull the income back into U.S. tax anyway, and the client's cost basis in the plan may differ from what the foreign statement shows.

This briefing walks through the framework we use with clients: what counts as a foreign pension or annuity, how treaties (and the saving clause) actually apply, how residency and withholding are established, and what belongs on the return. It closes with the reporting checklist we hand to preparers on these files.



What Counts as a Foreign Pension or Annuity

A foreign pension or annuity is a payment from a retirement plan or annuity contract sourced outside the United States. The payor can be a foreign employer, a trust the foreign employer established, a foreign government or one of its agencies (including a foreign social security system), a foreign insurance company, or another foreign entity set up to make the payments.

The taxable amount is generally the gross distribution less the client's cost, meaning their investment in the contract. That income can be fully or partly taxable even when no Form 1099 or comparable statement is issued, so absence of a form is not a reason to leave the income off the return.

How Treaties Allocate Taxing Rights

Most U.S. income tax treaties leave pension and annuity income to the resident country's own law, unless a specific treaty article changes that result. Some treaties go further and limit taxation to amounts that would have been taxable had the recipient been a resident of the paying country, and lump-sum distributions often carry their own special rule. Government pensions and social security payments are typically reserved to the paying country as well, though the treaty's own definition of "government pension" controls and can be narrower than clients expect.

Because these provisions vary treaty by treaty, and because protocols amend the original text, we do not generalize from one client's treaty to another's. Every engagement involving foreign retirement income starts with a read of the specific treaty article, the applicable protocol, and the Technical Explanation that accompanies it, since that Explanation is often where the definitions of "pension," "public pension," and "government service pension" actually live.



The Saving Clause: Why U.S. Citizens Rarely Escape Tax

Every treaty analysis for a U.S. citizen or resident has to clear the saving clause, typically Article 1. The saving clause preserves the United States' right to tax its own citizens and residents on worldwide income as though the treaty did not exist, subject only to a short list of exceptions written into that treaty.

In practice, this means a client cannot simply point to a favorable treaty article and exclude a foreign pension from their U.S. return. Unless the specific pension or annuity article is carved out of the saving clause, the distribution stays taxable in the United States regardless of what the treaty says about the paying country's rights.

Establishing Residency: The Tiebreaker Rules

Treaty benefits depend on residency, and residency is determined first under each country's own domestic law. On the U.S. side that means IRC § 7701(b): the green card test, the substantial presence test, or a first-year choice, all detailed in Publication 519.

When a client qualifies as a resident of both countries under their respective domestic rules, the treaty's tiebreaker provisions decide the client's single country of residence for treaty purposes. We apply them in order and stop at the first one that resolves the question:

TIEBREAKER ORDER

- Where the client has a permanent home available to them.
- If a permanent home exists in both countries, where the client's personal and economic relations are closer (their center of vital interests).
- If that is not decisive, where the client has a habitual abode.
- If that still does not resolve it, the client's citizenship or nationality.

If none of those steps settles the question, or if the treaty in question does not include tiebreaker language at all, the client's residency has to go to Competent Authority for a determination. Not every treaty includes a full tiebreaker chain, so this is a point worth confirming early rather than assuming.



Withholding and Claiming Treaty Benefits

The mechanics differ depending on which direction the payment flows:

FOREIGN RESIDENT RECEIVING A U.S. PENSION

- File Form W-8BEN with the U.S. payor to claim the treaty exemption from U.S. withholding.
- The form is only effective for treaty purposes if it carries a valid U.S. Taxpayer Identification Number.

U.S. RESIDENT RECEIVING A FOREIGN PENSION

- Claim the treaty withholding exemption in the form the foreign government requires.
- If the foreign withholding agent will not honor the claim, assert the treaty position directly on the return filed with the foreign country instead.
- Foreign income tax that is withheld can generally be claimed as a Foreign Tax Credit on the client's U.S. federal return.

Foreign Social Security and Government Pensions

Absent a specific treaty provision, a foreign social security pension is taxed the same way as any other foreign pension or annuity. It does not receive the partial exclusion that applies to U.S. social security benefits unless the relevant treaty says otherwise. Most U.S. treaties do provide that social security payments are taxable only by the paying country, but remember that the saving clause can still pull the benefit back into U.S. tax for a citizen or resident, so the treaty language is only half the analysis.

Government service pensions follow a similar pattern. Many treaties reserve taxation to the paying country when the recipient is a citizen or national of that country and not a U.S. citizen or green card holder, but the exact scope of that benefit, and whether the saving clause overrides it for a U.S. person, varies by treaty and needs to be checked article by article.



Cost Basis and Contribution-Related Rules

A client's cost basis, meaning their investment in the contract, can include employer contributions made before 1963, contributions made after 1962 under a plan that existed as of March 12, 1962, and contributions made after 1996 on behalf of a client serving as a foreign missionary. Contributions and employer contributions tied to compensation for services the client performed outside the United States while a nonresident, and that were not subject to U.S. or foreign income tax, are excluded from cost if they would otherwise have been taxable as cash compensation.

Cross-border treaty relief for pension contributions themselves is uncommon. A handful of treaties give a U.S. citizen living abroad favorable foreign tax treatment for contributions to a U.S. plan, or give favorable U.S. treatment for contributions to a foreign plan, but the benefit is treaty-specific and should never be assumed to carry over from one country to another.

Reporting Checklist

Before closing a file involving foreign retirement income, confirm the following:

CONFIRM AND DOCUMENT

- The source and character of the distribution (employer pension, government pension, foreign social security, or private annuity).
- The applicable treaty article, any amending protocol, and the Technical Explanation's definitions.
- The client's residency determination, including the tiebreaker analysis if dual residency applies.
- Whether the saving clause applies, and whether the pension or annuity article is carved out of it.
- The client's cost basis in the contract, including any pre-1963 or missionary-related contributions.
- Withholding claimed (Form W-8BEN for U.S.-source pensions) and any Foreign Tax Credit available for foreign withholding.



RELATED IRS FORMS AND PUBLICATIONS

- Form W-8BEN — Certificate of Foreign Status of Beneficial Owner for Withholding and Reporting.
- Publication 54 — Tax Guide for U.S. Citizens and Resident Aliens Abroad.
- Publication 515 — Withholding of Tax on Nonresident Aliens and Foreign Entities.
- Publication 519 — U.S. Tax Guide for Aliens.
- Publication 575 — Pension and Annuity Income.
- Publication 590-A and 590-B — IRA Contributions and Distributions.
- Publication 939 — General Rule for Pensions and Annuities.

This briefing is a general planning reference and does not replace a treaty-specific review. Every client fact pattern should be checked against the actual treaty article, protocol, and Technical Explanation in effect for that client's country before a position is taken on the return.