

This letter was mailed on Feb 21, 2009

14 Stonewall Circle
White Plains, NY 10607

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The Taxpayer Advocate
290 Broadway, 5th FL., Manhattan, NY 10007

Taxation of UN Pension

Dear Tax Officer,

Taxation of UN Pension funds (periodic payments)

I am writing to you because the UN is located in New York City. However, if this enquiry does not pertain to your department, please forward it to another federal tax department.

From reading publication 575 and 1040 instructions, I get the impression that the basis of periodic pension fund payments must be reduced from any lump-sum payments received before start of the UN pension annuity. However, there is another opinion that it is not the pension cost that should be reduced by the recovery period.

In the UN, it is mostly foreigners on G-4 visas who opt to retire in the US and get resident status and eventually US citizenship. So their lump-sum distributions (usually 1/3rd of pension costs) are tax free as at the time of payment they were neither residents nor citizens of the United States of America.

So, I want to give an example of a retiree on a G-4 visa that has a pension cost of \$300,000. This retiree opts for a 1/3rd lump sum payment and will receive the balance in periodic payments. For example, for this married individual we will assume that the recovery period is 360 months. Therefore, if this retiree gets a periodic pension of say \$4,000 a month what would be the correct approach for the recovery of the pension cost?

Approach 1:

Reduce the pension cost by 1/3rd. Therefore, the monthly part of the exclusion will be $\$200,000/360 = \555.55 . The annual exclusion will be $\$555.55 \times 12$ or \$6,667.

Approach 2:

Keep the pension cost at \$300,000 and the recovery period at 360 (according to IRS tables on the 1040 instructions).

Therefore the monthly annual exclusion will be $\$300,000/360 = \833.33 and the annual exclusion will be $\$833.33 \times 12$ or \$10,000.

However, under approach 2, by taking a lump-sum the retiree has in effect used 1/3rd of the recovery period or 120 months thereof. Therefore, he or she could recover the exclusion for only 240 months (or 20 years).

It is clear that both methods give the same financial results. However, which is the correct method to use? I believe a number of UN retirees living in the US have been using approach 2.

If method 1 is the correct method and folks have already been using method 2, can they continue using method 2 until the recovery period is over, the shorter period?

I am making this inquiry since I have a web log on which I post matters of interest for UN staff, so that they are correctly informed of these complex tax issues.

Thank you for your attention.

Yours truly,

Merrill Cassell