The Benefits of Malta Pension Strategies for U.S. Taxpayers

Written by a Tax Deferral Services tax practitioner.
Source available upon request

Every tax planner faces the challenge of identifying a tax strategy that provides for tax deferral and tax-favored distributions. Many taxpayers look to the Roth IRA, but the Roth is a limited option for high-net-worth taxpayers, who must contend with income eligibility restrictions, contribution limits, UBTI, and prohibited transaction limitations. One option with significant benefits for such taxpayers is the Malta Pension Plan, a vehicle that provides tax deferral and tax-favored distributions in a manner that is more powerful than a Roth IRA.

Overview

Since the enactment of the Tax Cuts and Jobs Act (TCJA) on December 22, 2017,[1] interest in the use of qualified retirement plans has increased. However, qualified retirement plans are not without their limitations and complications. For the closely held business owner, the controlled group and affiliated service group rules serve to limit the ability of business owners to discriminate in their own favor or to create duplicate pension arrangements to multiply the benefits of pre-tax contributions and tax deferral.[2]

Taxpayers perpetually scratch their heads looking for pathways to achieve tax reduction and tax deferral. U.S. taxpayers are taxed on their worldwide income.[3] Complex tax rules limit U.S. taxpayers' ability to generally achieve tax deferral through the use of foreign corporations.[4] Even if tax deferral can be achieved, the funds generally would be taxable when

---

[1] P.L. 115–97.

[2] See IRC §§ 414(b), 414(m).

[3] IRC § 61(a).

[4] See IRC §§ 951-965.

distributed back to the taxpayer. Code Section 911 allows a U.S. taxpayer to exclude $104,000 of foreign earned income in 2018.[5] Section 933 allows bond fide residents of Puerto Rico to exclude foreign income for federal tax reporting purposes.[6] However, there is a "catch" here. You have to live outside the United States to benefit from these tax code provisions.[7]

The challenge of identifying a tax strategy that provides for tax deferral and tax-favored distributions is a difficult planning proposition. This article discusses the planning utility of the Malta pension scheme as a vehicle that provides tax deferral and tax-favored distributions in a manner that is more powerful than a Roth IRA.[8]

I am a big fan of Anthony Bourdain (of blessed memory) and his show on CNN–*Parts Unknown*. The show was not really about food but rather about discovering the world through sharing the cuisine of and "breaking bread" with citizens from "less travelled" parts of the globe. The use of Malta Pension Plans is not unlike the show, in that Malta is off the grid for most Americans, and the strategy is equally off the grid of most tax planners.

The Malta Pension Plan is an excellent alternative to the Roth IRA. The Roth IRA, for all of its benefits, has many limitations. The Malta Pension Plan can fill these planning gaps in a powerful way. This article is an introduction to the Malta Pension Plan.

Overview of the Malta Pension Plan

The tax authority for the Malta Pension Plan (the Plan) is the income tax treaty between the United States and Malta, signed in 2008 and ratified in 2010 (the Treaty).[9]

---

[5] IRC § 911(a)(1). Unless specifically noted otherwise, all references to "Sections" in this article are to sections of the Internal Revenue Code of 1986 (the "Code" or "IRC"), as amended, and to regulations issued thereunder.

[6] IRC § 933. See also Puerto Rico Act No. 22 of 2012, available (in Spanish) at https://web.archive.org/web/20140514054655/http://www.oslpr.org/2009-2012/leyes/pdf/ley-22-17-Ene-2012.pdf; unofficialtranslationinto Englishavailableathttp://www.oeci.pr.gov/en/Documents/Act%20No.%2022-2012%2C%20as%20amended%20%28revised%20on%20December%2026%2C%202016%29.pdf. See also Puerto Rico Act No. 20 of 2012, available at http://www.oslpr.org/download/en/2012/A-0020-2012.pdf; Commonwealth of Puerto Rico, Dep't of Economic Development & Commerce, "Act 20: Tax Incentives to Promote Export Services in Puerto Rico" (n.d.), available at http://aaipr.upr.edu/wp-content/uploads/2017/04/ACT-20-PG_r1.pdf.

[7] IRC § 911(b)(2)(A).

[8] The use of the word "scheme" in American parlance usually carries a negative connotation whereas the word "scheme" is regularly used in British parlance. (The British also frequently use the world "brilliant" even when something is not "brilliant.")

[9] Convention between the Government of the United States of America and the Government of Malta for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (signed at Valletta Aug. 8, 2008; ratified July 15, 2010) [hereinafter Convention], available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/usmalta%20agreement.pdf.

The Plan is structured under Maltese law as a personal retirement benefits plan taking the form of a trust. The arrangement is subject to Maltese law. Participation in the Plan is restricted to United States persons (as defined in Section 7701(a)(30)) and to Maltese residents (other than U.S. persons).[10] The authority under Maltese law is Article 4 of the Retirement Pension Act 2011 under Chapter 514 of the law of Malta.[11] The Plan falls within the definition of a "pension fund" under Article 3(1)(k) of the Treaty.[12] The Plan is treated as a resident of Malta under Article 4 of the Treaty.[13]

The Plan has no contribution limit restriction and contributions to the trust may be made in cash or in kind. Each participant's assets in the Plan are held in a separate account. The participant's account is the sole source for payment of each participant's retirement benefits.

The normal retirement age under the Plan's pension plan rules is age 60. However, a participant may retire as early as age 50. A participant may also defer payment until his or her 75th birthday. Importantly, retirement benefits are not linked to employment or service with an employer. In that respect, the Plan is similar in structure to a traditional or Roth IRA.

The Plan contemplates the payment of retirement benefits in several forms during the lifetime of the participant: I

1. An initial lump sum;
2. Periodic distributions; and
3. optional lump sum distributions.

These distributions within the Plan meet the regulatory requirements under Maltese law.[14] The initial lump-sum payment provides for a distribution as early as age 50, permitting the participant to distribute up to 30 percent of the value of his or her account value. This initial lump sum can also be arranged as a series of payments paid within one year of the retirement date.

After the initial lump sum payment, Standard License Condition B.4.6.3 of the Maltese Pension Rules requires programmed payment using prudent actuarial principles. For example, the Plan administrator may distribute variable annuity payments on a monthly, quarterly, semi-annual, or annual basis (periodic payments).

---

[10] IRC § 7701(a)(30).

[11] Available at http://www.justiceservices.gov.mt/DownloadDocument.aspx?app=lom&itemid=11710&l=1.

[12] Convention, article 3(1)(k).

[13] Id.

[14] See Malta Fin. Servs. Auth., "Pension Rules for Occupational Retirement Schemes Issued in Terms of the Retirement Pensions Act, 2011," pt. B.4.6.3 (Retirement Benefits for a Defined Contribution Retirement Scheme) (the "Maltese Pension Rules"), available at file:///C:/Users/emj/Downloads/Part%20A%20and%20Part%20B_Pension%20Rules_Occupational_Retirement_Schemes.pdf. These rules are issued pursuant to Article 38(2) of the Malta Retirement Pensions Act, supra note 11.

Subject to a valuation of the Plan's assets to provide a "sufficient retirement income" over the participant's lifetime, the Plan may provide that 50 percent of the excess value may be distributed as an additional lump sum. The additional lump sum payment may be distributed as early as the fourth year of the Plan and made every year after that. These payments reduce the amount of the programmed periodic payments. The minimum retirement income under Maltese law is the Maltese minimum wage, which is approximately $10,225 per annum.[15]

Maltese law allows for the tax-free transfer from one Plan administrator to another. In the event the participant dies before all of the Plan balance has been distributed, the remaining Plan benefits may be paid to the Plan's beneficiaries in a lump sum or rolled over as a new Plan for the beneficiaries.

Taxation of the Malta Pension Plan

General Overview. The Treaty provides preferential tax treatment to Malta pension plans that meet the definition of a "pension fund" under Articles 4, 17, and 18. Under the properly structured fund, the Plan is a resident for treaty purposes under Article 3(1).[16] From the U.S. perspective, the Plan has attributes that are very similar to traditional and Roth IRAs. Under the later-in time rule, the Treaty should take precedence in the case of any discrepancy between it and the Internal Revenue Code.[17]

The Plan, like a Roth IRA, is funded with after-tax dollars. It is also structured as a trust like a Roth IRA. Investment income within the Plan is not currently taxed. Unlike the U.S. Model Treaty, the Treaty provides that the beneficiary is only taxable in the participant's country of residence (the U.S.) and must exempt from taxation a pension distribution that is tax exempt in the other country (Malta). As a result, only Plan distributions that are taxable under Maltese law are taxable to U.S. Plan participants.

Under Article 18 of the Treaty, the U.S. only taxes income once it has been distributed from the plan and becomes taxable under Article 17(1)(b) of the Treaty; and not income that arises within the Plan but hasn't been distributed.[18] This tax treatment requires a U.S. taxpayer to claim Treaty benefits for

---

[15] □747 per month. See "Malta National Minimum Wage," available at h[illegible]y economy.com/national-minimum-wage/malta.

[16] Convention arts. 4, 17, 18, 3(1)(k).

[17] See IRC §§ 894(a), 7852(d).

[18] Convention art. 3(1)(k).

each of the years in question by filing IRS Form 8833.[19] Under Article 1(4) of the Treaty, Treaty Article 18 is excepted from the "saving clause" allowing the U.S. to tax Plan income.[20] Article 22(2) of the Treaty treats a U.S. resident as a "qualified person" for Treaty purposes.[21]

The initial lump sum distribution is not subject to taxation in Malta and is therefore not subject to taxation to a U.S. participant under Article 17(1) of the Treaty. Additional lump sum distributions that may be made as early as Year 4 and every year thereafter are also not subject to taxation in Malta but the U.S. periodic distributions are subject to taxation in Malta and therefore are subject to taxation to a U.S. participant. A U.S. taxpayer is taxable under the Treaty only when income is subject to taxation as a periodic payment for U.S. purposes in Malta under IRC Sec 72 and Article 17(1)(b).[22]

Periodic payments made under the Plan are subject to taxation in Malta and therefore would subject the U.S. taxpayer to taxation.[23] The periodic payments would be taxed under Section 72, which governs annuity distributions. Plan administrators frequently use Table V (Ordinary Life Annuities; One Life—Expected Return Multiples) as set out in Treasury Regulation Sec- tion 1.72-9 to determine the taxable component of pension plan payments that depend on the life expectancy of one or more individuals.[24] Section 72 provides a mechanism in which a portion of an annuity payment is treated as gross income and the remainder is treated as tax-free return of invest- ment (essentially allocating portions of the payment between a Member's original investment in the Pension Fund and accumulated income within the plan). Integral to proper application of Section 72 is understanding the terms "exclusion ratio" and "annuity starting date."

Plan Examples. The following examples illustrate how a Malta Pension Plan works.

> ***Example 1:*** Plan participant Mary contributes $3 million of after-tax funds to the Plan. As of the annuity start date, Mary's Plan account is worth $5 million—i.e., the accumulated earn- ings attributable to Mary's original contribution is $2 million. Only $2 million will be treated as income for U.S. tax purposes.

---

[19] IRS Publication, "About Form 8833 Treaty-Based Disclosure Under Section 6114 and 7701(b), available at https://www.irs.gov/forms-pubs/about-form-8833.

[20] Convention art. 17(1).

[21] See also Convention arts. 1(4), 18.

[22] Convention art. 17(1)(b).

[23] Id.

[24] Treas. Reg. § 1.72-9.

The remaining $3 million is tax-free. The exclusion ratio is 60 percent, thus 60percent of each periodic payment is treated as tax-free. The balance of any payment is taxable at ordinary income rates.

Note: The initial lump sum payment should not reduce the participant's basis but instead be treated as a distribution under Article 18 of the Treaty.

Example 2: Enterprising Johnny (age 45) has a direct investment of $1 million in a technology company that undergoes an IPO. The expectation is that the value of Johnny's shares will appreci- ate to $11 million following the IPO. Following the IPO, Johnny plans to sell the shares for $11 million. Once that's done, Johnny would like to reinvest his proceeds in a managed account. He is a U.S. citizen, a resident of New York City, and is married with two children.

To accomplish his goal, Johnny transfers the shares to the Plan, tax free. Following the IPO, the shares are sold, and the resulting proceeds are reinvested in the Plan. Johnny's Plan account achieves a 7.5 percent return (net of fees) for a 10-year period. The Plan account has grown to $19 million when, at age 55, Johnny decides to begin distributions from the Plan.

The Plan account is made up of three components: (1) the initial contribution ($1 million); (2) the untaxed sales proceeds ($10 million); and (3) $8 million of untaxed portfolio gains from the date of the sale. Johnny is eligible to take 30 percent of the account value ($5.7 million) as a tax-free distribution. The balance of the funds remain available to provide periodic retirement payments of $465,000 per year. In this situation, $35,000 is treated as a return of principal and the balance of each payment, $430,000, is taxable at ordinary income rates for Malta and U.S. purposes.

Beginning in Year 4, Johnny is able to take additional lump-sum distributions equal to 50 percent of the excess value above the lump-sum value necessary to provide periodic payments. The projected value of the amount necessary to provide the annual annuity is $10.1 million. The excess amount is $8.9 million. Fifty percent of the excess eligible amount for tax-free treatment is $4.45 million. The total amount of tax-free distributions in the example is $10.15 million.

Foreign Trust Treatment for U.S. Tax Purposes. The structure of the arrangement is a trust under Malta law. Under U.S. tax law, the trust is considered a grantor trust for income tax purposes, and not a business trust. A 2015 private letter ruling held that a foreign entity organized as a trust under

foreign law whose responsibility was to "protect and conserve the superannuation fund" constituted a trust for tax purposes under Treasury Regulation Section 301.7701-4(a).[25] According to that regulation:

> Generally speaking, an arrangement will be treated as a trust under the Internal Revenue Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The trust is a foreign trust because a U.S. court in the United States is not able to exercise primary supervision over its administration (the "court test"), and the administrator for the Plan is not a U.S. person. It is a foreign grantor trust because it meets all of the elements of Section 679(a):

- The transferor is a U.S. person;
- Property is transferred to the trust by the U.S. person;
- The trust is a foreign trust; and
- The trust has a U.S. beneficiary.[26]

The participant's contribution to the Malta Pension Plan in cash does not trigger any taxation. Additionally, the participant's contribution of an appreciated capital asset should not trigger any taxation on the transfer. The general gain recognition rule described above does not apply to a transfer to a foreign trust by a U.S. person to the extent that any person is treated as the owner of such trust under Section 671.[27]

Reporting Obligations. The Plan participant has annual reporting obligations in the United States. The participant is responsible for filing Form 3520 at the time of formation. The Plan should provide the participant with Form 3520-A with the participant's information for annual reporting. The participant should also file FBARs (FinCEN Report 114) and Form 8938 (Statement of Specified Foreign Financial Assets) in connection with its participation in the Plan.

Taxation Upon Participant's Death. At death the value of the Plan is included in the participant's taxable estate. Section 684(b) exempts the initial

---

[25] PLR 201538008 (June 11, 2015) (citing Treas. Reg. § 301.7701-4(a)).

[26] See IRC § 679(a).

[27] See IRC § 684(b); Treas. Reg. § 1.684-3(a).

transfer to the Plan because of its grantor trust status.[28] However, at the death of the participant there would be a taxable event under Treasury Regulation Section 1.684-2(c)(1) with respect to any gain in Plan assets at that time.[29] No Treaty provision provides an offset. Plan assets are not eligible for a step-up in basis under Section 1014.[30]

Nevertheless, the Plan may be rolled over to a new Plan in effect to a beneficiary who is a U.S. resident for tax purposes without any taxation to the beneficiary based on Article 17(1)(b) of the Treaty.

Special Tax Considerations. The 3.8 percent tax on net investment income is preempted by the Treaty, and Section 1411 is therefore not applicable to the income accumulated within the Plan.

Based on the Plan's status as a foreign grantor trust and Treaty provisions, the Plan should not be subject to withholding under the Foreign Investment in Real Property Tax Act (FIRPTA).[31] Based on the Plan's tax status, both the Plan as a seller and the buyer could obtain a withholding certificate stating that there is no tax owed on the transfer. Generally, the Plan should be able to assert Treaty benefits each year by filing Form 8833 related to the sale of any U.S. real estate.

Planning Opportunities With the Malta Pension Plan

The Roth IRA Alternative. The following discussion illustrates how a Malta Pension Plan is preferable to a Roth IRA in many cases.

Roth IRA Basics. The Roth IRA came into existence with the passage of the Taxpayer Relief Act of 1997.[32] (Its chief legislative sponsor was Senator William Roth of Delaware, hence the name.) As for a traditional IRA, the annual contribution limit in 2019 to a Roth IRA is only $6,000, but individuals age 50 and over can contribute up to $1,000 extra per year—to "catch up"—for a total of $7,000. A non-working spouse can open a Roth IRA based on the working spouse's earnings. Unlike a traditional IRA, however, contributions to a Roth IRA, are made with after-tax dollars and not only can appreciate untaxed while held in the IRA but generally will not be taxed upon distribution, either. One of the major limitations of the Roth IRA

[28] See also Treas. Reg. § 1.684-3(a).

[29] Treas. Reg. § 1.684-2(c)(1).

[30] IRC § 1014(c).

[31] See Omnibus Reconciliation Act of 1980, P.L. 96-499, 94 Stat. 2599, 2682 (adding IRC § 897 and making conforming amendments to other Code sections).

[32] P.L. 105-34, 111 Stat. 787.

is eligibility for high-net-worth investors. Specifically, the contribution and income limits deliver a knockout punch to such taxpayers. For single filers in 2019, that income threshold starts at $122,000 (up from $120,000) and ends at $137,000 (up from $135,000). In that range, one's contribution is limited, eventually reaching zero. For married-filing-jointly filers (and quali- fying widow(er)s) in 2019, that income threshold starts at $193,000 (up from $189,000) and ends at $203,000 (up from $199,000). Clearly, the benefits of the Roth IRA disappear pretty quickly for high-net-worth investors in regard to new contributions into the Roth IRA.[33]

Another limitation is that contributions to the Roth IRA must be made in cash. The prohibited transaction guidelines applicable to the traditional IRA also apply to Roth IRAs. The unrelated business taxable income (UBTI) rules also apply to Roth IRAs. The combination of the prohibited transaction rules and the UBTI rules limit the taxpayer's ability to own his or her business interests within the Roth IRA.

The primary difference between the Roth IRA and the traditional IRA or qualified plan is that the Roth IRA does not have required minimum distributions. As noted earlier, distributions from a Roth IRA are not subject to income taxation. However, the distribution from the Roth IRA must be a "qualified" distribution. Qualified distributions require five years of "seasoning" within the plan, unless the taxpayer is at least age 59½.

Distributions before age 59½ are subject to a 10 percent early withdrawal penalty as well as normal tax treatment on the distribution (as if it were a traditional IRA). As with the traditional IRA, exceptions to these rules exist for a distribution for a first-time home buyer; distribution to a disabled taxpayer, or a distribution to a beneficiary on account of the taxpayer's death.

The Roth IRA account balance is included in the taxpayer's taxable estate. At death, the remaining distribution of the account is subject to the same rules as the traditional IRA. A surviving spouse as the beneficiary of the Roth IRA can treat the Roth IRA as her own. Other beneficiaries must distribute the balance over their life expectancies. The taxpayer may have had the benefit of deferred income while still alive, but faces the inclusion of the Roth assets in his taxable estate.

Malta Pension Plan's More Favorable Tax Treatment. Unlike the Roth IRA, the Plan does not have contribution limits, and the participant has the ability to contribute to the Plan either in cash or in kind. The investment income within the Plan is tax deferred. The Plan generally does not have

---

[33] See IRC § 408A on the Roth IRA rules. For additional explanation, see https://www.irs.gov/retirement-plans/amount-of-roth-ira-contributions-that-you-can-make-for-2019; https://www.irs.gov/retirement-plans/plan-participant-employee/amount-of-roth-ira-contributions-that-you-can-make-for-2018.

a required minimum distribution requirement but does contemplate some amount of distribution by the time the participant reaches age 75. While the Plan balance is included in the participant's taxable estate, the Plan may be rolled over to the beneficiary's separate plan without taxation. As discussed further below, the Plan permits an investment in U.S. real estate without consideration of UBTI or FIRPTA (Foreign Investment in Real Property Tax Act of 1980) withholding. It also provides the participant the ability to extract significant distributions without taxation, through the initial and additional lump sum payments.

A Vehicle for Investment in Real Estate. Real estate provides another example illustrating the superiority of the Maltese Plan over traditional or Roth IRAs.

The UBTI Problem for IRA Investments in Real Estate. Funds within a regular IRA may be rolled over to a new self-directed IRA or a Roth IRA and used to purchase residential or commercial real estate for investment purposes. In many cases, the investor may want to leverage the investment using debt financing. It is a good idea to increase the return on equity and investment, but this may lead to a bad result tax-wise. The problem is the specter of UBTI created by debt financing.

Net UBTI income will be taxed at the trust tax rate because an IRA is considered a trust for tax purposes and not a corporation. The top marginal tax bracket for trusts for federal tax purposes is 39.6 percent, which is applicable at $11,950 of trust income[34] (or 37 percent and $12,500 for taxable years 2018 through 2025[35]). If you aren't already beginning to think twice, consider the additional layer of taxation for state tax purposes. Pretty soon, you can have a tax disaster on your hands.

UBTI is defined in Section 512 as income from a "trade or business" that is regularly carried on by the tax-exempt organization, but which is not substantially related to the exempt organization's exempt purpose or function. It also applies to pension plans and IRAs. Congress instituted this tax to prevent tax-exempt organizations from having an unfair advantage over taxable organizations.

UBTI is a concern to pension plans and IRAs because it converts income that would otherwise be tax exempt into taxable income. UBTI includes income from debt-financed property.[36] When debt is used by an IRA or pension plan, tax is applied to that portion of the gain that is debt-financed.

[34] IRC § 1(e)(2).

[35] IRC § 1(j)(2).

[36] IRC § 514.

Any property held to produce income is debt-financed property if at any time during the tax year there was acquisition indebtedness outstanding for the property. When any property held for the production of income by an IRA is disposed of at a gain during the tax year, and there was acquisition indebtedness outstanding for that property at any time during the 12-month period before the date of disposition, the property is debt-financed property.

In general, average acquisition indebtedness for any tax year is the average amount of the outstanding principal debt during the part of the tax year the property is held by the entity or IRA. Both income and gains will be subject to taxation in the property based upon the ratio of debt financing relative to the adjusted basis of the property. Any gains will be subject to capital gains taxation.

No UBTI Issue for Malta Pension Plans. Plan administrators may typically restrict debt financing to 50 percent of the property value. This restriction is a discretionary limitation that is not specified statutorily in Maltese law. As a foreign grantor trust, the use of debt financing does not create UBTI treatment to the Plan. As a result, the Plan is far more attractive than a Roth IRA for real estate investment.

A Drop Off Plan for EB-5 Investors. Congress established the EB-5 program in 1990 as a way to stimulate the U.S. economy through job creation and capital investment by foreign investors. The program is administered through United States Citizenship and Immigration Services (USCIS).[37] The program sunsets every three years and requires renewal by Congress to continue. In 2014, Chinese applicants accounted for more than 85 percent of the EB-5 applications with 9,128 applicants.[38]

EB-5 visas are for foreign investors (1) who make a direct minimum investment of $1 million in an ongoing business, or (2) who start a new business in the U.S. that preserves or creates 10 or more jobs for U.S. workers.[39] The direct investment requirement is reduced to $500,000 if the investment is made in a targeted employment area.[40] Investment is made through a private or public economic entity, known as an EB-5 Regional Center, devoted to

---

[37] Immigration Act of 1990, P.L. 101-649, § 121, 104 Stat. 4978.

[38] Miriam Jordan, "Investor Visa Soaked Up by Chinese" (Wall St, J., Aug. 27, 2014), available at https://www.wsj.com/articles/investor-visas-soaked-up-by-chinese-1409095982. The cap for EB-5 visas is set at 10,000 per year. No country may have more than 7 percent of the total number of EB-5 visas. However, because of unallocated visas a country such as China may exceed the 7 percent annual cap.

[39] Immigration and Nationality Act of 1952, P.L. 82–414, INA § 203(b)(5)(c); 8 CFR § 204.6(c).

[40] INA §§ 203(b)(5)(B)(ii), 216A.

increased domestic capital promotion, job creation, and improved regional productivity.

Upon making an EB-5 investment and upon approval of the application, a foreign investor (and the investor's immediate family including children under age 21) will be granted conditional permanent residence.[41] A foreign investor-applicant who can show that the investment satisfies the EB-5 job creation requirements after two years will be granted permanent residence.

Foreign investors are entitled to permanent residency under the EB-5 program only if they put the minimum-required investment ($1 million under the Investor Program or $500,000 under the Pilot Program) "at risk." Capital is "at risk" only where there is a chance for a loss or a gain.[42]

The U.S. is one of the few countries that require residents and citizens to pay tax on their worldwide income. U.S. nationality exposes an individual to worldwide income taxation by the United States, regardless of other nationality.[43] Dual nationals with U.S. citizenship are subject to U.S. income tax—even if they are unaware of their U.S. citizenship. A dual national who lives outside the United States from birth, and indefinitely thereafter, and who takes no action to lose U.S. nationality, remains subject to taxation as a U.S. citizen.

The United States taxes the income of permanent residents as defined in Section 7701(b) from all sources, domestic or foreign.[44] A resident alien is taxed on his worldwide income regardless of the source. Therefore, a green card holder is subject to worldwide taxation whether he or she lives in the U.S. or abroad. Worldwide taxation also applies to "substantial presence" residents if they fail the mechanical test of substantial presence even where there is an intent to be domiciled abroad.

That all sounds awful, but the EB-5 investor with Green Card status can use the Malta Pension Plan to defer income on his or her non-U.S. investments and minimize taxation on worldwide income as a consequence of becoming a U.S. resident.

An Alternative to the Charitable Remainder Trust. In order to understand and appreciate the benefits of a Malta Pension Plan as an alternative to a Charitable Remainder Trust (CRT), it is important that we understand and appreciate the CRT.

---

[41] INA §§ 203(b)(5), 216A.

[42] 8 CFR § 204.6(i)(2).

[43] IRC §§ 1, 61.

[44] IRC § 7701(b).

CRT Basics. The CRT is an irrevocable agreement in which the tax- payer/donor transfers assets to a trust in exchange for an income interest.[45]

The trust is known as a split interest trust. The CRT is "split" between
(1) an income interest and (2) a remainder interest which passes to one or more charities. The value of the remainder interest needs to be at least 10 percent of the gift. The CRT is exempt from income taxation, and in addition allows the donor to claim an income tax charitable deduction based on the value of the remainder interest.

The arrangement permits the tax-free sale of appreciated assets and irrevocably designates the remainder portion between one or more charitable beneficiaries. The charitable beneficiary can be a single beneficiary, donor- advised funds, and/or private foundations.

The donor enters into a trust agreement with the trustee to transfer cer- tain assets to be managed and maintained by the trustee. In accepting the assets, the trustee agrees to pay an income stream to one or more designated income beneficiaries for the rest of their lives or for a designated period of time (term of years). At the expiration of the trust term, the trustee of the charitable remainder trust delivers the remaining trust assets to the charitable remainder beneficiary.

CRT distributions to income beneficiaries are taxed using a unique four- tier system of accounting. This system utilizes a "worst-in-first-out" method for characterizing income distributions in the hands of the income benefi- ciaries. Each item of income earned by the trust must be separately tracked according to type (e.g. interest, dividends, capital gains, tax-exempt interest, etc.). Then each type of income is "used up" starting with items taxed at the highest rate and moving in tern to items that are taxed at the next lower rate. The end result is that ordinary income items, such as interest, are passed out first (Tier I), followed by short-term capital gains, then long-term capital gains (Tier II), tax-exempt interest (Tier Ill), and finally trust principal (Tier IV).[46]

Any CRT earnings in excess of the income beneficiary distributions are retained in the trust in a tax-free environment and combined with future transactions for characterizing future income beneficiary distributions. Note that while the CRT avoids taxation on capital gains realized from the sale of appreciated assets, such gains may be used to characterize future income beneficiary distributions.

The taxpayer may use several forms of a CRT. The principal distinc- tion between the various forms of charitable remainder trust is the manner in which the trust agreement defines the income interest. The trust must

---

[45] INA §§ 664(d)

[46] See IRC § 664 regarding the rules for charitable remainder trusts and the four-tier distribution rules of IRC § 664(b).

specify that the income interest will be paid as: (1) a fixed amount (annuity) known as a Charitable Remainder Annuity Trust, or CRAT, or (2) a fixed percentage of the trust's assets revalued annually (a Charitable Remainder Unitrust, or CRUT).

The longer the charity must wait, and the greater the income payments to the income beneficiaries, the lower the amount of the charitable deduction. This computation is complex and is generally performed using specialized software. The amount of the deduction of the gift of the charitable remain- der interest is generally limited to 30 percent of the donor's adjusted gross income for most long-term capital gain property for public charities and 20 percent to private foundations. Deductions that are denied because of the deduction limitations, may be carried over for the next five tax years.

One major limitation of the CRT is the rules dealing with self-dealing and UBTI. The UBTI rules are designed to prevent tax-free treatment to investment income that is unrelated to the charitable purpose of the pub- lic charity. The consequences of UBTI treatment are severe for a charitable remainder trust. Previously, even one dollar of UBTI within a CRT would disqualify the trust. Section 664(c) now imposes a 100 percent excise tax on any UBTI within a charitable remainder trust.

How a Malta Pension Plan Solves the Roth IRA Problem. The Malta Pension Plan solves the limitations of the Roth IRA for high net worth and high income taxpayers:

- *Problem 1—High net worth taxpayers make too much money to con- tribute to a Roth IRA:* The Malta Pension Plan does not have any participation restrictions related to income.
- *Problem 2—Even if high net worth and high income taxpayers could contribute to a Roth IRA, the contributions are limited to cash:* The Malta Pension Plan allows taxpayers to contribute capital assets to the Plan in kind. Contributions of appreciated assets to the Plan do not trigger any taxation on the transfer.
- *Problem 3—The Roth IRA rules have some investment restrictions:* The Malta Pension Plan does not have any investment restrictions. Roth IRAs are subject to the unrelated business taxable income which impacts the ability to invest in operating businesses or real estate that use debt-financing.
- *Problem 4—Although the Roth IRA is not subject to required mini- mum distribution requirements that traditional IRAs and pension assets face, but distributions may not be made earlier than age 59 ½ without adverse taxa treatment:* The Malta Pension Plan allows for a tax-free lump sum distribution of 30 percent of the Plan account value as early as age 50 without taxation.

Conclusion

Most high-net-worth taxpayers would adopt a Roth IRA or increase invest- ment through Roth IRAs were it not for income eligibility restrictions, contri- bution limits, UBTI, or prohibited transaction limitations. The Malta Pension Plan provides a significant pathway to overcome these limitations. Most important are the absence of contribution limits for a Plan and the ability to make in-kind contributions to the Plan without triggering gain on appreciated assets. The ability to take significant distributions of deferred income on a tax-free basis parallels the benefits of the Roth IRA in a way that is funda- mentally more beneficial to high-income and high-net-worth investors.