

Anonymous Letter to IRS Lays Out Defense of Malta Pension Plans

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A 43-page unsigned letter sent to the IRS lays out likely legal opposition to a proposed regulation that would require taxpayers to disclose transactions in Maltese retirement plans, says attorney Andrew Gradman.

After the IRS in June released proposed regulations to identify Malta pension plans as a listed transaction, the agency received a 43-page anonymous letter challenging the competent authority arrangement between the US and Malta, which purported to shut down MPPs.

For those following the MPP saga, the letter is a must-read. It's a road map for the arguments we can expect for years to come in the tax press and in civil and criminal courts. Using this road map, we also can predict where Malta pension plans will meet their demise.

Malta pension plans assume an investment into a pension fund as defined in the 2008 US-Malta tax treaty. This generally means an entity that (if established in Malta) is a licensed fund or a scheme of which more than 75% of the participants reside in either contracting state, which is tax-exempt, and operated principally "to administer or provide pension or retirement benefits."

To dismantle the Malta pension plan scheme, the competent authority arrangement clarified that a putative pension fund would fail the "operated principally" requirement if it could accept non-cash contributions, or if it didn't limit contributions by reference to earned income from personal services. And it applied this retroactively, claiming it was the "original intent" of the parties.

To refute the arrangement, one would have to show that without the arrangement, the operated-principally requirement permitted the Malta pension plan scheme. The anonymous letter addressed this over 19 pages. The complexity is understandable—the task at hand is to define a term (the operated-principally requirement) given minimal guidance.

For lawyers, this kind of vagueness can be scary but also exciting, because it's an invitation to make up any definition that's good for your client. That was what Malta pension plans promoters did before the 2021 arrangement. The anonymous letter carries on the tradition.

Assuming the 2008 treaty defined the operated-principally requirement in a way that favors Malta pension plans, their defenders also must show that the competent authorities can't redefine that requirement now.

The arrangement drew this authority from two treaty articles. One of them, Article 25(3), provides that the competent authorities “shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the convention.” Particularly, they may agree “to the settlement of conflicting application of the convention, including conflicts regarding” the meaning of any term that the convention uses.

The plain language seems clear—because the operated-principally requirement isn’t defined, the competent authorities can define it. However, the anonymous letter argues that, when these provisions are read in context, a different interpretation emerges.

The letter states that no part of Article 25 “allows the competent authorities of their own initiative to enter into an agreement interpreting a treaty to disadvantage taxpayers.” It also states that Article 25 fails to “provide the competent authorities with independent ability, of their own accord, to issue interpretations of the treaty other than to provide relief from double taxation.”

I disagree. Rev. Proc. 2006-54 notes that although the competent authority procedures are available at a taxpayer’s request, the “US competent authority also may initiate competent authority negotiations in any situation deemed necessary to protect US interests.” In addition, commentary to the 2008 US-Malta treaty states that the power to define terms can be exercised not only “to prevent double taxation” but also “to further any other purpose of the convention.”

A similar statement appears in an OECD treaty commentary, which provides that this power extends not merely to “individual cases” involving a single taxpayer but also more generally through an interpretation that applies to “a large number of taxpayers.” Further, it specifies that this power could be used “where a conflict in meaning under the domestic laws of the two states” leads to “an unintended or absurd result”—exactly what happened with the operated principally requirement.

The anonymous letter implies that Article 25 embodies some pro-taxpayer animating principle. That would surprise me. The phrase “avoidance of double taxation” in treaties doesn’t merely refer to individual taxpayers. Double taxation (or, in the case of pensions, failure to honor another state’s tax exemption) is also an assault by one country on another country’s tax base and on its ability to make public policy. It helps to remember that the treaty is between the US and Malta. Taxpayers are not a party.

Having your transaction listed is no fun. But participants in Malta pension plans already have been identifying themselves to the IRS on Form 8833. For whomever wrote the anonymous letter (and printed and scanned it, so we couldn’t view the metadata), additional disclosure is the least of their concerns.

A recent Bloomberg Tax Insight summarized that the IRS doesn’t have it easy if it chooses to pursue criminal claims against taxpayers. I tend to agree; I think the IRS will probably leave taxpayers alone. But promoters, attorneys, and other professionals can’t rely on arguments that the article makes.

The anonymous letter was a shot across the bow, warning the IRS how the writer or writers intend to pursue their defense.

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