U.S.-Australian Dual Taxation Issues: Superannuation Funds and the U.S.-Australia Income and Estate Tax Treaties

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U.S.-Australian Dual Taxation Issues: Superannuation Funds and the U.S.-Australia Income and Estate Tax Treaties

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Ed has over 39 years of experience dealing with a variety of international tax matters. He specializes in tax consulting services to a wide variety of clients ranging from closely held companies to multi-national businesses. His expertise includes domestic and foreign income and social security tax planning, tax compliance for individuals and corporations, tax treatment of incentive compensation plans, international assignment program administration and policy design.

Prior to establishing his own firm, Ed was with KPMG LLP, where, in addition to providing the above services, he served as the US firm’s lead for international social security matters.

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Introduction

- Australia-based taxpayers – whether individuals or entities – increasingly engage in United States activities/maintain United States holdings
  - For individuals, United States investments can either be passive or part of ongoing American connections
    - Significant planning opportunities exist for nonresidents with United States activities – though improper structuring of activities can create draconian American tax consequences
  - Corporate entities with United States operations are subject to tax on United States-sourced business profits
- United States taxpayers with Australian activities/assets are also subject to special tax rules by both jurisdictions
  - Cognizance of Australia-specific factors – both from the tax and business perspective – is critical when entering the market

U.S. Taxpayers

- United States citizens and residents are taxable on their worldwide income
  - Sourcing determinations less relevant – taxable on all income, whether domestic or foreign-sourced
  - Entities typically domiciled based on place of formation/incorporation
- Foreign tax credits alleviate burdens of double taxation for U.S. taxpayers with Australia-sourced income
  - Generally, citizens/residents utilize FTC rather than income tax treaties
    - Tax treaties contain “savings” clause, exempting citizens/residents from most treaty benefits
- United States taxpayers subject to capital gains on worldwide asset dispositions

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Taxpayer Classification

- Which individuals are United States taxpayers?
  - Citizenship – persons born in the United States, naturalized in the United States, or (under specified circumstances) where parents were United States citizens at the time of their birth
  - Classified as a "resident" for United States income tax purposes if:
    - Lawfully admitted for permanent residence (green card holder); or
    - Meet substantial presence requirements
      - Substantial presence test: must be present in the United States for 31 days during the relevant tax year and the sum of days for the last three years (after use of applicable multipliers) exceeds 183
  - Individuals not classified as United States taxpayers termed "nonresident aliens" for income

Taxpayer Classification

- Who is a U.S. taxpayer?
  - Exceptions exist to resident classification: (1) closer connection to another country and (2) treaty tiebreaker provisions
    - Closer connection exception: look to whether individual's facts and circumstances show a closer connection to another country
      - Available *only* for substantial presence residents!
    - Income tax treaties – individuals classified as residents of both treaty party countries are reclassified as a resident of only the one which contains their permanent adobe or (if a permanent abode available in both) their "center of vital interests"
      - Available to *both* substantial presence residents and green card holders – but <u>not</u> citizens!
        - Treaty reclassification **only** for income tax liability purposes – information reporting requirements largely unmodified

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U.S. Taxpayers – Interests in Australian Corporate Entities

- Special tax rules come into play for U.S. taxpayers with interests in foreign corporations
  - Technically, the foreign corporation is respected as a separate taxpayer; however, current inclusion (irrespective of corporate distributions) can be required for U.S. shareholders
    - Subpart F/GILTI regimes create current inclusion for significant income amounts if ownership thresholds met
    - Passive foreign investment company ("PFIC") rules do not require ownership thresholds, and carry potential for punitive tax ramifications on dispositions/excess distributions
  - Special anti-deferral rules inapplicable to flow-through entities – because no deferral occurs!
    - Threshold question: How is a foreign entity classified for U.S. tax purposes?

U.S. Taxpayers – Interests in Australian Corporate Entities

- Foreign-domiciled business entities generally are able to elect their entity classification for United States tax purposes
  - EXCEPTION: Per-se corporations (as listed in the Regulations)
    - Australian public limited company automatically classified as a corporation under U.S. rules
  - Default rules for classification exist, which hinge on the limited liability of owners/members
    - If limited liability for owner/owners – association taxable as a corporation
    - If no limited liability for at least one owner – partnership if multiple members, disregarded entity if one
  - Elections out of default rules are available - can elect to be a partnership, corporation, or disregarded entity
    - Election made on Form 8832 – initial election required within 75 days of entity becoming "relevant"

U.S. Taxpayers – Interests in Australian Corporate Entities

- Subpart F imposes a direct tax on a U.S. shareholder of a controlled foreign corporation ("CFC") as to the CFC's Subpart F income
  - Tax imposed directly on U.S. shareholder, regardless of whether distributions of income are made to the shareholder
    - Provides a method for the United States to disincentivize transactions improperly sourcing income to foreign jurisdictions
- Threshold requirements must be met for Subpart F regime to apply
  - Requirements: look to (1) whether a U.S. shareholder exists, (2) whether there is a CFC, and (3) whether the CFC has Subpart F income
    - U.S. shareholder – United States person owning at least 10% of the foreign corporation's voting stock *or* value
    - Controlled foreign corporation exists if on any day during a given year U.S. shareholders own more than 50% of the stock of the foreign corporation

U.S. Taxpayers – Interests in Australian Corporate Entities

Subpart F income is primarily comprised of "movable income" – income that can be shifted to foreign jurisdictions more easily

- Foreign base company income is typically the largest component of Subpart F income
  - Includes foreign personal holding company income, foreign base company sales income, foreign base company services income, etc.
    - Foreign personal holding company income: dividends, interest, rents, royalties, annuities
      - Also includes certain net gains from sale of property which generates passive income
    - Foreign base company sales/services income – look to activities outside the corporation's country of domicile and the transactions with related persons

U.S. Taxpayers – Interests in Australian Corporate Entities

- What if Subpart F application requirements are not met?
  - No mechanism for immediate tax is implemented; however, prospective distributions by the foreign corporation (or dispositions of the shares of the foreign corporation) potentially subject to PFIC regime
    - PFIC – punitive ramifications for shareholders of foreign corporations with significant passive income
      - Income automatically classified as ordinary (taxable at highest rates), with an interest charge applicable based on the holding period for the interest
  - Sec. 1297(d) – if a shareholder's interest in a foreign corporation meets both Subpart F and PFIC requirements, only Subpart F applies
    - Often preferable to apply Subpart F – tax accelerated, but punitive PFIC ramifications avoided

U.S. Taxpayers – Interests in Australian Corporate Entities

- Under Sec. 951A, U.S shareholders of a controlled foreign corporation must include their share of global intangible low-taxed income in US tax
  - GILTI: Excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return
  - U.S. shareholder and controlled foreign corporation concepts mirror Subpart F
    - GILTI inclusion treated similarly to Subpart F in many ways, but not technically a component of Subpart F
  - **50% deduction available for GILTI, but ONLY for C-Corporations!**
    - Makes the effective tax rate for corporate shareholders 10.5%
    - For non-corporate U.S. shareholders, rate can be 37%

U.S. Taxpayers – Interests in Australian Corporate Entities

- GILTI Application
  - Functionally, GILTI essentially is tax imposed on U.S. shareholders of a CFC on the excess of an assumed 10% rate of return on tangible business assets of the CFC
    - GILTI imposes a minimum tax on foreign earnings that exceed a standard rate of return amount
  - No direct reference to intangibles is made in Sec. 951A
    - Aim may have been intangible income, but application will be significantly more far-reaching, and not limited to one type of income (i.e. movable income)

U.S. Taxpayers – Direct Australian Activities

Foreign-Derived Intangible Income ("FDII")

- A deduction is allowed to *domestic corporations* in an amount equal to 37.5% of the FDII of the domestic corporation for the tax year
  - Deduction ONLY available to C-corporations!
- FDII equals deemed intangible income multiplied by a fraction: foreign-derived deduction eligible income over deduction eligible income.
  - FDII is the portion of intangible income derived from serving foreign markets; like GILTI, it assumes a 10% rate of return on tangible assets
    - FDII concept offers a special reduced effective tax rate on income from US-held intangibles; concept does not explicitly look at intangibles but assumes a fixed rate of return on business assets with the balance of income being from intangibles

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Australian Taxpayers – Australia-U.S. Income Tax Treaty

- The United States and Australia maintain an income tax treaty, which (upon election) can alter tax ramifications for Australian-resident taxpayers with United States-sourced income
  - Under treaties, residents of a treaty country can (by election) be taxed at a reduced rate, or even exempted from tax, on specified items of income from the other country
    - i.e. withholding taxes on United States-sourced income
  - Savings clause prevents a United States citizen/resident/entity from using a tax treaty to alter tax on US-source income
  - Treaty-based positions generally must be disclosed
    - Subject to exemptions under the Regulations

Australian Taxpayers – Australia-U.S. Income Tax Treaty

- Residency takes on importance in this realm – generally Australian taxpayers are entitled to treaty benefits only when they are residents of Australian under Australian tax rules
  - Treaty definitions of residence normally include persons liable for tax to a country based on domicile, residence, citizenship, place of management, or place of incorporation
    - Corporations are residents of countries for these purposes if liable for tax based on the country being its place of management
      - Can have conflicts as to residence where place of management and place of incorporation differ
        - Tiebreaker typically is the treaty between those two countries
  - Rules exist to prevent "treaty shopping" – entity creation solely for purposes of treaty benefits

Australian Taxpayers – Australia-U.S. Income Tax Treaty

- Treaty modifications for business income – "effectively connected to a United States trade or business" shifted to business profits attributable to a permanent establishment
  - Treaty Article 7(1)
  - Heightened standard for U.S. taxation – though threshold still low
- Dividends – if a U.S. company pays a dividend to an Australian shareholder, the U.S. tax rate is reduced to 5-15% (depending on the recipient's ownership level)
  - Treaty Article 10(2)
    - Under limited circumstances, source country tax can be removed under Art. 10(3) – if recipient owns 80% or more of the payor and other qualification requirements are met

Australian Taxpayers – Australia-U.S. Income Tax Treaty

- Treaty modifications for dependent (employee) personal services – income taxable by source country except if (1) employee present in source country for <183 days, (2) compensation paid by an employer not a resident of the source country, and (3) compensation not borne by a permanent establishment or fixed base of the employer in the source country
  - Treaty Article 15(2)
- Royalty income limited to 10% American tax where earned by an Australian qualified resident, unless the Australian resident maintains an American permanent establishment/fixed place of business
  - Art. 12

III. Types of Income and Taxation

General Personal Income Taxation Concepts

- A resident individual is subject to Australian income tax on a worldwide basis, i.e. income from both Australian and foreign sources (except for certain foreign income and gains of temporary residents)
- A non-resident individual is liable to Australian income tax only on income (other than interest, royalties, and dividends, which are generally subject to withholding tax [WHT]) derived from sources in Australia, and certain statutory income that is taxable on a basis other than source (e.g. certain capital gains).
- Australia has no surtaxes, alternative, or other income taxes on personal income.

Personal Income Taxation Rates - Residents

Taxable Income			
Over	Not Over	Tax on Column 1	Marginal Rate on Excess
0	18,200	0	0
18,200	37,000	0	19%
37,000	90,000	3,532	33.5%
90,000	180,000	20,797	37.0%
180,000		54,097	45.0%

These tables do not include the Medicare levy of an additional 2% of taxable income, which applies to most residents. An additional Medicare levy surcharge of between 1% and 1.5% applies to certain higher income taxpayers not covered by health insurance for private patient hospital cover. Special rates apply to unearned income of children below the age of 18 years at year end where that income is more than AUD 416.

Personal Income Taxation Rates - Nonresidents

Taxable Income			
Over	Not Over	Tax on Column 1	Marginal Rate on Excess
0	90,000	0	32.5%
90,000	180,000	29,250	37.0%
180,000		62,550	45.0%

Nonresidents are not required to pay the Medicare levy.

Residence

- Individuals are residents of Australia if they reside in Australia, and this includes the following:
  - Individuals whose domicile is in Australia, unless they have a permanent place of abode outside Australia.
  - Individuals who have actually been in Australia for more than one-half of the income year (i.e. at least 183 days in the income year), unless the individual's usual place of abode is outside Australia and the individual does not intend to reside in Australia.
  - If the individual is an 'eligible employee' for the purposes of legislation relating to the superannuation entitlements of Federal public servants.
- Persons who take up a contract of employment in Australia may be regarded as residents if they are in the country for more than six months. Citizenship and nationality do not determine liability for Australian income tax.

Temporary Residence

- A temporary resident for tax purposes is, broadly, an individual who:
  - Holds a temporary visa granted under the Migration Act 1958
  - Is not an Australian resident within the meaning of the Social Security Act 1991, and
  - Does not have an Australian spouse as defined in the Social Security Act 1991.
- A temporary resident will be exempt from Australian tax on foreign source income, while a resident of Australia is subject to tax on worldwide income.
- Tax treaties may modify the definition of residency.

Other Taxes

- There are no social security taxes in Australia.
- There is a 2% Medicare levy discussed previously.
  - A surcharge of between 1% and 1.5% applies to high income taxpayers where the taxpayer and their dependents are not covered by a private health insurance fund registered in Australia that provides basic hospital cover.
  - Both employers and foreign nationals working in Australia should take care in choosing a health fund which both qualifies for the exemption from the Medicare levy surcharge and provides adequate cover because it is possible to have a policy that provides full cover but does not also exempt the policy holder (and their family members) from the surcharge and vice versa.
  - Proper advice should be sought from a tax expert to ensure that the policy covers both aspects.

Other Taxes

- Australia does not have a net worth tax.
- Generally, there are no estate and gift taxes, with certain exceptions.
- Fringe Benefits Tax:
  - Fringe benefits are not taxable in the hands of the employee.
  - Instead, a separate tax collection procedure applies to fringe benefits, with the tax known as FBT, which is levied on the employer.
  - FBT is not a creditable tax for Form 1116 purposes. Employers must determine whether it is more tax-effective to provide cash allowances or fringe benefits.

Determination of Taxable Income

- Employment Income – cash remuneration arising from employment
- Non-cash Benefits – subject to employer FBT at 47% rate grossed up at a factor of 2.0802 where employer was entitled to an input tax credit for GST and 1.8868 factor for other fringe benefits

FBT Comparison

	Housing Allowance	In-Kind Housing (FBT)
In-Kind Value or Cash Allowance	$50,000	$50,000
Gross-up	$40,909	
FBT		$44,430
Total Grossed-up Cost	$90,909	$94,340
Australian Individual Income Tax Consequences:		
Income	$90,909	$0
Tax Gross-up	$40,909	$0
FBT	$0	$0
Australian Employer Tax Cost	$40,909	$44,430

FBT Comparison

	Housing Allowance	In-Kind Housing (FBT)
U.S. Individual Income Tax Consequences:		
Income	$90,909	$50,000
Tax (and gross-up if needed)	$33,636	$29,635
FTC	($33,636)	
Gross-up		
Net after FTC	$90,909	$79,635
U.S. Employer Cost	$0	$29,635
Total Employer Tax Cost	$40,909	$73,305

Determination of Taxable Income

- Equity Compensation – any discount at grant is either taxable at grant or can be deferred until the earlier of the following:
  - No real risk of forfeiture
  - Employee exercises rights
  - Employee ceases employment
  - 15 year after rights were acquired

Determination of Taxable Income

- Capital Gains
  - Generally taxed as ordinary income
  - For assets held at least 12 months there is a 50% gain discount
- Deductible expenses:
  - Employment expenses
  - Expenses related to the production of income
  - Superannuation contributions
  - Charitable contributions

IV. Australian Superannuation Funds

Australian Superannuation Funds

- One of the three pillars of Australia's social security program:
  - 1st Pillar – Age Pension – low income/asset thresholds (means tested).
  - 2nd Pillar – Superannuation Guarantee (currently 9.50% - increasing to 12.00% by 2025).
    - Essentially privatized social security.
    - Part of Australian SSA per Totalization Agreement.
  - 3rd Pillar – Savings outside Supers and "concessional" and "non-concessional" contributions to Supers.
- July 2017 reforms enshrined Super legislative mandate provide income in retirement to substitute or supplement the Age Pension.
- Superannuation assets as of June 2020 aggregate $2.9 trillion. *Source: AFSA Superannuation Statistics (June 2020)*

Superannuation Funds

- Retirement system is trust-based, common law structured retirement income
- Until 1993, a funded DB “superannuation” was almost universal
- A change to mandatory superannuation moved the country to about 99% DC
- Now all employers must provide a 9.5% annual contribution

Australian Superannuation Funds – Cont'd

- Supers receive concessional tax rates:
  - Contributions Phase: 15%.
  - Accumulation Phase: 15%.
  - Pension Phase: generally taxed at 0%.
- Win-Win tax treatment for Australian employers and members.
- Supers are NOT so super for Australian member beneficiaries who are also U.S. citizens or green card holders.

Australian Superannuation Funds – Cont'd

Types of Super Funds:

- Retail Funds
- Industry Funds
- Public Sector Funds
- Corporate Funds
- Self-Managed Superannuation Funds ("**SMSFs**")
- Small APRA Funds ("**SAFs**")

Australian Superannuation Funds – Cont'd

Working holiday makers (WHMs)

- Basically short-term workers
- As a working holiday maker, the first $37,000 of income is taxed at 15% and the balance is taxed at ordinary rates. Generally no Australian social security contributions required. WHMs have a visa subclass of either:
  - 417 (Working Holiday)
  - 462 (Work and Holiday).
- A working holiday maker's employer also has to pay superannuation if the individual is an eligible employee.
- An eligible employee is an individual who meets both of the following requirements:
  - 18 years or older
  - Paid $450 or more (before tax) in a month.
- Upon departure Australia the WHM can apply to have the super paid as a departing Australia superannuation payment (DASP).
- The tax on any DASP made to WHMs on or after 1 July 2017 is 65%. (DASP is discussed later.)

Stumped on Supers?

- Super is a hybrid structure which has no equivalent in the United States.
- Just three nonbinding IRS rulings on Supers to date.
- Internal IRS emails under FOIA confirm lack of uniform approach to classification of Supers.
  - Superannuation Guarantee portion is equivalent to U.S. social security under AUS-U.S. Totalization Agreement.
  - Superannuation contributions and earnings have share similar characteristics with other foreign national pension plans (UK, Singapore, UK, New Zealand) which are exempt from U.S. taxation under U.S. tax treaties.
- U.S. Tax Reform application to Supers:
  - Transition Tax
  - GILTI Tax

Popular Tax Reporting Theories on “Supers”

1. Super as a foreign nonqualified Section 402(b) employee trust for U.S. Member.
   - IRS Form 1040 inclusion with no FTCs.
     - Employer contributions.
     - Employee contributions.
     - Earnings.
     - Distributions.
   - FinCEN Form 114 - FBAR disclosure and penalties.
   - IRS Form 8938 exemption under AUS-U.S. IGA.
   - IRS Forms 3520, 3520-A for foreign trust reporting.
   - IRS Form 8621- Passive Foreign Investment Company (“**PFIC**”).
   - IRS Form 709 – U.S. estate taxes may apply.

Popular Tax Reporting Theories on “Supers”

2. Super as a foreign nonqualified Section 402(b) employee trust for U.S. Member who is HCE and plan is discriminatory
   - IRS Form 1040 inclusion with no FTCs.
     - Employer contributions.
     - Employee contributions.
     - Annual increase in value.
     - Distributions.
   - FinCEN Form 114 - FBAR disclosure and penalties.
   - IRS Form 8938 exemption under AUS-U.S. IGA.
   - IRS Forms 3520, 3520-A for foreign trust reporting.
   - IRS Form 8621- Passive Foreign Investment Company (“**PFIC**”).
   - IRS Form 709 – U.S. estate taxes may apply.

Popular Tax Reporting Theories on "Supers" – Cont'd

3. Supers as foreign grantor trusts owned by U.S. Members.
    a. Applicable where employee contributions > employer contributions only to extent of employee contributions. Treated as employee trust for employer contributions.
    b. If not treated as employee's trust, considered as grantor trust for entire balance.

- IRS Form 1040 inclusion with no FTCs.
    - Employer contributions.
    - Employee contributions.
    - Distributions.
- FinCEN Forms 3520, 3520-A for foreign trust reporting.
- IRS Form 114 – FBAR disclosures and penalties.
- IRS Form 8938 exemption under AUS-U.S. IGA.
- IRS Form 8621 - PFIC reporting obligations.
- IRS Form 709 – U.S. estate taxes may apply.

Popular Tax Reporting Theories on "Supers" – Cont'd

4. Super as investment or business trust classified as a corporation.
   - IRS Form 1040 inclusion with no FTCs.
     - Employer contributions – Subpart F income.
     - Employee contributions – Subpart F income.
     - Income and capital gains accruals – Subpart F income.
     - Distributions – Pre-taxed earnings, no U.S. tax to extent previously taxed as Subpart F income while in accumulation phase.
   - IRS Forms 5471 – Reporting of Super as controlled foreign corporation (CFC).
   - IRS Form 8621 – Return for Super as Passive Foreign Investment Company (PFIC).
   - FinCEN Form 114 - Reporting of Super accounts for FBAR purposes.
   - IRS Form 8938 - Reporting of Super as exempt foreign financial asset under FATCA -
     - Exemption under Annex II of the AUS-U.S. IGA.
   - IRS Form 709 – U.S. estate taxes may apply.

Popular Tax Reporting Theories on "Supers" – Practical Conclusions

- If the employer contributions are greater than employee contributions, most practitioners treat is as a Section 402(b) employee's trust.
- If the employee contributions are greater than the employer contributions, most practitioners bifurcate the reporting:
  - Employer contributions treated as Section 402(b) trust
  - Employee contributions are treated as grantor trust
- It is important to understand the contribution mix to determine the reporting obligation.

Tax Treaty to the Rescue? Not Really

- IRC §894: income of any kind, to the extent required by a U.S. treaty, will be exempt from U.S. income taxation.
- U.S.-Australia Tax Treaty:
  - Entry into force in 1983.
  - Protocol in 2001.
- Article 2(3) – Savings Clause:
  - U.S. reserves the right to tax its citizens on a worldwide basis as if the Tax Treaty were not in force.

Tax Treaty to the Rescue? Not Really

- Article 18 – Pensions, Annuities, Alimony & Child Support:
  - Article 18(1): Subject to the provisions of Article 19 (Governmental Remuneration), pensions and other similar remuneration paid to an individual who is a resident of one of the Contracting States in consideration of past employment shall be taxable only in that State. This is subject to the saving clause, so the U.S. will tax its citizens and residents regardless of their residency.
  - Article 18(4): The term "pensions and other similar remuneration", as used in this Article, means periodic payments made by reason of retirement or death, in consideration for services rendered, or by way of compensation paid after retirement for injuries received in connection with past employment.
  - The term “pension” is not specifically defined in the Code. The general definition determining whether a payment constitutes a “pension” for treaty purposes is as follows (this specific language is from PLR 8904035, but many other PLRs use similar language):
    - the Employee must either have been employed for five years or must be aged 62 or older at the time the Distribution is made;
    - The Distribution must be made (A) on account of the Employee’s death or disability, (B) paid as part of a series of substantially equal payments over the Employee’s life expectancy (or over the joint life expectancy of the Employee and his or her beneficiary), or (C) paid on account of the Employee’s retirement under the Plan after attaining age fifty-five; and
    - All Distributions are made either after the Employee has separated from service with X or on or after attainment of age 70 and 1/2.
  - The above requirements ensure that the Distributions will occur upon retirement after long-continued and faithful service. See Rev. Rul. 71-478 , 1971-2 C.B. 490.

Tax Treaty to the Rescue? Not Really

- Article 18 – Pensions, Annuities, Alimony & Child Support:
  - Supers do not meet the definition of "pension" as set forth in the Treaty.
  - Social Security payments and other similar **public** pension payments paid by one country to a resident of the other country or to a U.S. citizen will be taxable only by the paying country. This rule, which is not overridden by the saving clause, exempts U.S. citizens and residents from U.S. tax on Australian social security payments and Australian residents from Australian tax on U.S. social security payments.
  - Nowhere in the Treaty does it consider super accounts as social security.

- Article 19 – Government remuneration:
  - Public sector Supers are government remuneration taxable only in Australia.
  - Savings clause trumps exemption for workers who were already U.S. citizens and Australian residents (but not Australian citizens) while working for Australian government.

Tax Treaty to the Rescue? Not Really

- Article 21 – Income Not Expressly Mentioned
  - If one takes the position that the super is not as pension for purposes of Article 18(1), then it would likely fall under the provisions of Article 21.
  - Article 21 provides that as a general rule, items of income not otherwise dealt with in the proposed treaty which are derived by residents of either country shall be taxable only by the country of residence. This provision is subject to the saving clause, so U.S. citizens who are Australian residents would continue to be subject to U.S. taxation on their worldwide income.
  - Thus you get the same result whether it is considered a pension or not.

Tax Treaty to the Rescue? Not Really

- Final Comments:
  - The Treaty does not expressly address the taxation of supers. It is hard to argue that a super is a social security type plan, so the fallback position is that you have to look at it using the employee trust provisions of Section 402(b).
  - Article 21 would also assign taxation to the U.S. by virtue of the savings clause if not taxed under Article 18.
  - The Treaty needs to be revised to eliminate uncertainty as to the taxation of supers.

Departing Australia Superannuation Payment (DASP)

- Individuals working in Australia on a temporary visa and contributed to a super can apply to have this super paid as a departing Australia superannuation payment (DASP) after departing Australia.
- Eligibility requirements:
  - The individual accumulated superannuation while working in Australia on a temporary resident visa issued under the Migration Act 1958 (excluding Subclasses 405 and 410)
  - The visa has expired or been cancelled
  - The individual has left Australia and does not hold any other active Australian visa
  - The individual is not an Australian or New Zealand citizen, or a permanent resident of Australia.
- New Zealand citizens leaving Australia permanently may be able to transfer super to New Zealand under the Trans-Tasman retirement savings portability scheme for individuals.
- Payments will be taxable in U.S. under the Section 72 rules (i.e. how much has been previously taxed).

Departing Australia Superannuation Payment (DASP)

- For Australian purposes, DASP payment will be subject to a final withholding tax

Payment Component	DASP ordinary tax rate (for non-WHM)	DASP WHM tax rate
Tax-free component	nil	nil
Taxable component – taxed element	35%	65%
Taxable component – untaxed element	45%	65%

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Exception for Certain Tax-Favored Foreign Retirement Trusts and Nonretirement Savings Trusts

- Forms 3520 and 3520-A are not required in the case of certain retirement and nonretirement savings trusts
- Applies in general to an eligible individual with respect to tax-favored foreign retirement trusts and nonretirement savings trusts subject to the following:
  - Written restrictions, such as contribution limitations
  - Conditions for withdrawal
  - Host country information reporting

Exception for Certain Tax-Favored Foreign Retirement Trusts and Nonretirement Savings Trusts

- Eligible individual
  - An individual who is, or at any time was, a U.S. citizen or resident;
  - Is compliant (or comes into compliance) with all requirements for filing a U.S. federal income tax return (or returns) covering the period such individual was a U.S. citizen or resident; and
  - To the extent required under U.S. tax law, has reported as income any contributions to, earnings of, or distributions from, an applicable tax-favored foreign trust on the applicable return (including on an amended return).

Tax-Favored Foreign Retirement Trust

- A foreign trust for U.S. tax purposes that is created, organized, or otherwise established under the laws of a foreign jurisdiction (the trust's jurisdiction) as a trust, plan, fund, scheme, or other arrangement (collectively, a trust) to operate exclusively or almost exclusively to provide, or to earn income for the provision of, pension or retirement benefits and ancillary or incidental benefits and meets the following requirements:

Tax-Favored Foreign Retirement Trust

- Withdrawals, distributions, or payments from the trust are conditioned upon reaching a specified retirement age, disability, or death, or penalties apply to withdrawals, distributions, or payments made before such conditions are met.
- Rollovers from other tax-favored retirement trusts are permitted.
- The trust is generally exempt from income tax or is otherwise tax-favored under the laws of the trust's jurisdiction.

Tax-Favored Foreign Retirement Trust

- Annual information reporting with respect to the trust (or of its participants or beneficiaries) is provided, or is otherwise available, to the relevant tax authorities in the trust's jurisdiction.
- Only contributions with respect to income earned from the performance of personal services are permitted.
- Contributions to the trust are limited by a percentage of earned income of the participant, are subject to an annual limit of $50,000 or less to the trust or are subject to a lifetime limit of $1,000,000 or less to the trust.

V. U.S. Australia Totalization Agreement

Totalization Agreements

- Bilateral Social Security Agreements ("Totalization Agreements")
  - Assign social security coverage to the country where the worker has the greatest attachment
  - Legally binding in the U.S. in the same manner as income tax treaties
- Totalization agreements have two principal purposes:
  - Relief from duplicate social security tax
  - Provide for coordination of benefits
- Agreements may assign coverage differently than U.S. domestic law would

Totalization Agreements

- From the U.S perspective, application of provisions are not elective
  - Controlled through length of assignment agreements and employment relationship
    - In order to maintain coverage when sent by home country employer, assignment must be less than five years to maintain home country coverage
    - Termination of home country employment relationship and establishment of host country employment relationship generally results in host country coverage

Agreements in Force

Australia	Germany	Norway
Austria	Greece	Poland
Belgium	Hungary	Portugal
Brazil	Iceland	Slovak Republic
Canada	Ireland	Slovenia
Chile	Italy	Spain
Czech Republic	Japan	Sweden
Denmark	Korea	Switzerland
Finland	Luxembourg	United Kingdom
France	Netherlands	Uruguay

U.S. / Australia Agreement – Applicable Laws

- United States
  - Title II of the Social Security Act and regulations pertaining thereto, except sections 226, 226A and 228 of that title and regulations pertaining to those sections,
  - Chapters 2 and 21 of the Internal Revenue Code of 1986 and regulations pertaining to those chapters;
- Australia
  - Social Security laws:
    - age pension;
    - disability support pension for the severely disabled;
    - pensions payable to widowed persons; and
    - carer payment.
  - The superannuation guarantee

U.S. / Australia Agreement – Age Pension

- Age requirement
  - Born before 1 July 1955 – 66 years
  - Born between July 1955 to 31 December 1956 – 66 years and 6 months
  - Born after 1 January 1957 – 67 years
- Amount

U.S. / Australia Agreement – Age Pension

- Amount

Per fortnight	Single	Couple Each	Couple Combined	Couple apart – ill health
Max Basic Rate	$860.60	$648.70	$1,297.40	$860.60
Max Supplement	$69.60	$52.50	$105	$69.60
Energy Supplement	$14.10	$10.80	$21.20	$14.10
Total	$944.30	$711.80	$1,423.60	$944.30

U.S. / Australia Agreement – Age Pension

- Income Test

Per fortnight	Single	Couple
No reduction	$178	$316
Over “no reduction” amount	50 cents for each $1 over “no reduction” amount	50 cents for each $1 over “no reduction” amount

U.S. / Australia Agreement – Age Pension

- Assets Test

	Homeowner	Non-homeowner
Single	$268,000	$482,000
Couple	$401,500	$616,000

U.S. / Australia Agreement – Carer Payment

- “Carer” payment: NOT A TYPO
- Eligible individuals must be providing constant care in the home of one of the following:
  - Someone who has a severe disability or severe illness
  - Someone who is frail aged
  - 2 to 4 children younger than 16 whose needs equal 1 child with severe needs
  - 1 or 2 children younger than 16 and 1 adult whose needs equal 1 child with severe needs.

U.S. / Australia Agreement – Carer Payment Requirements

- Be under the pension income and assets test limits
- Be an Australian resident
- Care for someone who is an Australian resident
- Care for 1 or more people who have care need scores high enough on the assessment tools used for an adult or child
- Care for someone who'll have these needs for at least 6 months or the rest of their life.
- Same income/assets test as for Old Age Pension

U.S. / Australia Agreement – General Rules Regarding Coverage

- Territoriality Rule
  - An individual is subject to taxation exclusively in the country in which he or she is working
- Detached Worker Exception
  - Designed to minimize disruptions in coverage of workers temporarily working outside their home countries
  - A person temporarily transferred to work for the same employer in another country remains covered only by the country from which he or she has been sent
  - Applies to temporary assignments expected to last no more than 5 years

U.S. / Australia Agreement – Applicability

- Only applies in the following circumstances:
  - Where individual would be subject to double coverage
  - Where individual has been sent from the U.S. to Australia and the U.S. SSA has issued a ‘Certificate of Coverage” to allow the individual to maintain U.S. coverage

U.S. / Australia Agreement

- Interaction With U.S. Internal Revenue Code
  - Wages exempt from FICA tax to the extent they are subject exclusively to the laws applicable to the social security system of such foreign country IRC §3101(c) and §3111(c)
- Certificate Of Coverage
  - Documents continued coverage by the home country and thus support the claim of exemption in the host country
  - Important to have in case of payroll audits
  - IRS may assess U.S. FICA contributions in the case of inbound assignees where no Certificate of Coverage was obtained even if agreement assigns coverage to home country

U.S. / Australia Agreement – Related Entities

- U.S. to Australia transfers
  - Applicable where employment relationship remains with U.S. employer; or
  - Transfers to foreign entity where U.S. parent has made a Section 3121(l) election to cover all U.S. citizens and resident alien employees by that entity
- Australia to U.S. transfers
  - Only applicable where U.S. entity is a member of the same wholly or majority owned group

Self-employed persons

- Where a person who is a resident of the United States works in the capacity of a self-employed person, the person shall be subject to the laws of only the United States.
- Where a national of the United States who is a resident of Australia works in the capacity of a self-employed person, the person shall not be subject to the laws of the United States.
- Where the same activity is considered to be self-employment under the laws of one Party and employment under the laws of the other Party, that activity shall be treated according to the provisions of this Article concerning self-employment.
  - Example - directors

Multiple transfers

- Detached worker exception will apply where a person who has been sent by his or her employer from the territory of a Party to the territory of a third State is subsequently sent by that employer from the territory of the third State to the territory of the other Party.
- Continuous home country coverage is required.
- Example: U.S. worker sent to U.K., maintains U.S. coverage under detached worker exception and is then sent from U.K. to Australia. Provided the detached worker exception is met for the Australian assignment, worker will maintain U.S. coverage.

Ships and aircraft

- A person, or that person's employer, who would otherwise be covered under the laws of both Parties with respect to employment of that person as an officer or member of a crew on a ship or aircraft shall, with respect to that employment, be subject only to the laws of the Party of which that person is a resident.

Applicability of Vienna Convention

- This Agreement shall not affect the provisions of the Vienna Convention on Diplomatic Relations of April 18, 1961, or of the Vienna Convention on Consular Relations of April 24, 1963.

Diplomats

- If an employee:
  - Is subject to the laws of one Party ("the first Party");
  - Was sent, whether before, on or after the entry into force of this Agreement, by the Government of the first Party to work in the territory of the other Party ("the second Party");
  - Is working in the territory of the second Party in the employment of the Government of the first Party;
  - Is not working permanently in the territory of the second Party; and
  - Is not exempt from the laws of the second Party by virtue of the Vienna convention;
- The Government of the first Party and the employee shall be subject only to the laws of the first Party, and, if the spouse of the employee also meets these conditions specified in subparagraphs 3-5 above, the spouse and the Government of the first Party shall be subject only to the laws of the first Party for that employment.

Extensions Beyond the Five-Year Initial Period

Country	Extensions of Time Allowed (practical experience)
Australia	4 years

Totalization of U.S. Benefits

- Where a person has completed at least six quarters of coverage under United States laws, but does not have sufficient periods of coverage to satisfy the requirements for entitlement to benefits under United States laws, the Agency of the United States shall take into account, for the purpose of establishing entitlement to benefits under this Article, periods of Australian working life residence which do not coincide with periods of coverage already credited under United States laws.
- In determining eligibility for totalized benefits, the SSA credits one quarter of coverage for every three months of Australian working life residence certified by the Agency of Australia; however, no period of Australian working life residence shall be credited for any calendar quarter already credited as a quarter of coverage under United States laws. The total number of quarters of coverage to be credited for a year shall not exceed four.

Totalization of U.S. Benefits

- Where an individual is eligible for a totalized benefit, the SSA will compute a pro rata Primary Insurance Amount in accordance with United States laws based on (a) the person's average earnings credited exclusively under United States laws and (b) the ratio of the duration of the person's periods of coverage completed under United States laws to the duration of a coverage lifetime as determined in accordance with United States laws. Benefits payable under United States laws shall be based on the pro rata Primary Insurance Amount.
- Entitlement to a totalized benefit terminates with the acquisition of sufficient periods of coverage under United States laws to establish entitlement to an equal or higher non-totalized benefit.
- Windfall Elimination Provision (WEP) only applies to non-totalized benefit.

Totalization of Australian Benefits

- Where a person to whom this Agreement applies has claimed an Australian benefit under this Agreement and has accumulated:
  - A period as an Australian resident that is less than the period required to qualify that person, on that ground, for that benefit under the laws of Australia;
  - A period of Australian working life residence equal to or greater than the period identified in accordance with paragraph 4 for that person; and
  - A United States period of coverage,
- Then for the purposes of a claim for that Australian benefit, that United States period of coverage shall be deemed, only for the purposes of meeting any minimum qualifying periods for that benefit set out in the laws of Australia, to be a period as an Australian resident.

Totalization of Australian Benefits – Residency Requirements

- For the Old Age Pension Australia requires that the person be an Australian resident for at least 10 years, including at least five consecutive years, and must be an Australian resident and resident in Australia when the claim is made.
- Article 8 of the Agreement provides as follows:
  - Where a person would be qualified under the laws of Australia or by virtue of this Agreement for a benefit except for not being an Australian resident and in Australia on the date on which the claim for that benefit is lodged, but:
  - Is an Australian resident or residing in the United States or a third State with which Australia has concluded an agreement on social security that includes provision for cooperation in the assessment and determination of claims for benefits; and
  - Is in Australia, or the United States or that third State, that person, so long as he or she has been an Australian resident at some time, shall be deemed, for the purpose of lodging that claim, to be an Australian resident and in Australia on that date.

VII. Dual taxation relief

Foreign Tax Credits

- Australian residents are allowed a foreign tax offset for foreign taxes paid on non-Australian-sourced income.
- The United States allows U.S. citizens and residents a foreign tax credit for foreign taxes paid on foreign source income

Treaty Withholding Rates – U.S. / Australia Treaty

Income Type	Treaty Withholding Rate
Interest	10%
Dividends – General	15%
Dividends – 10% or more owned affiliate	5%
Pensions and Annuities	0%
Social Security	30% of 85%
Royalties	5% (generally)

Nonresident Individuals – Transfer Taxes

- Estate tax: nonresident individuals subject to tax on all property (whether tangible or intangible) sitused within the U.S.
  - Subject to some exceptions (such as bank accounts not used in association with a U.S. trade or business)
  - Real property and tangible personal property are sitused in accordance with where the assets are physically located
    - Shares of a corporation are sitused in the country in which the corporation is formed
  - Nonresident individuals receive a $60,000 estate tax exclusion with a maximum 40% rate of tax applicable

Nonresident Individuals – Transfer Taxes

- Gift tax: nonresidents normally are subject to gift tax on lifetime gratuitous transfers of tangible property within the United States
  - Generally comprising real property situated within the country and tangible personal property within the U.S. at the time of the gift, including hard currency or cash situated within the U.S.
    - Intangible property (i.e. shares of a corporation) is not subject to gift tax for nonresident alien donors
- No specific gift tax exclusion for nonresident individuals, though the $15,000 per donee annual exclusion is available

Nonresident Individuals – Transfer Taxes

- The United States and Australia also maintain a treaty for transfer taxes, permitting some modification of default U.S. transfer tax rules
  - Article 3: provides general situs rules for property owned at time of death
  - Article 4(2): domiciliaries of Australia receive a heightened exclusion for American transfer taxes!
  - For dual domiciliaries, no tiebreaker provisions but tax credits provided

Reporting for United States Taxpayers – FBAR

- **FinCEN Report 114 ("FBAR") – look to foreign financial accounts**
  - Filed by United States persons with financial interests in or signature authority over foreign financial accounts where the aggregated value of accounts exceeds $10,000 at any point during the year
    - United States persons – U.S. citizens, residents, corporations, trusts, estates, partnerships, LLCs
    - Reportable accounts – checking/savings accounts, mutual funds, policies with cash values, securities accounts, etc.
    - Financial interest – owner of record/holder of legal title or person with beneficial interest
      - Attribution rules exist – majority owner of a corporation/partnership must report entity's assets, even if she does not have signature authority!
- FBAR requirements exist under Title 31 – *not* Title 26!
  - Though Service enforces FBAR requirements, this is not technically a tax form!

Reporting for United States Taxpayers – Form 8938

- **Form 8938 – look to foreign financial accounts or interests in foreign corporations/partnerships**
  - Required for U.S. taxpayers with interests in specified foreign financial assets
    - Specified foreign financial assets: foreign accounts, interests in foreign entities, etc.
      - Where asset reported on another tax information form, duplicative reporting on Form 8938 unrequired
        - Does *not* include FBAR filing!
    - Filing thresholds:
      - Residents of the United States – aggregated value of $50,000 at end of year or $75,000 at any time during year; $100,000/$150,000 if married filing jointly
      - Nonresidents (who are still U.S. taxpayers) - $200,000/$300,000 if single; $400,000/$600,000 if married filing jointly

Reporting for United States Taxpayers – Form 8621

- **Form 8621 – look to PFIC interests; must be a foreign corporation!**
  - Filed by taxpayers with interests in passive foreign investment companies ("PFICs")
    - Importantly, non-U.S. mutual funds are almost always classified as PFICs
      - For foreign pensions, Form 8621 requirements can depend on the structure of the pension
  - Investments in PFICs subject to high tax rates and onerous reporting requirements
    - Alternatives for default tax rules exist: QEF election and mark-to-market election, but election availability limited
      - QEF available only if receiving a PFIC Annual Information Statement from the foreign corporation
      - Mark-to-market available only if stock in the foreign corporation traded on a regulated securities exchange

Reporting for United States Taxpayers – Form 3520

- **Form 3520 – filed in connection with (1) foreign trust interests and (2) gifts/bequests from nonresidents**
  - Filed by:
    - Responsible party for reporting a reportable event that occurred during tax year or transferred property to a foreign trust in exchange for an obligation
    - U.S. person who is treated as the owner of any part of the assets of a foreign trust
    - U.S. person receiving distributions from a foreign trust
    - U.S. person receiving distributions from foreign persons or entities
      - Foreign bequests/gifts – filing requirement exists when receiving more than $100,000 from a nonresident alien individual which are treated as gifts or bequests

Reporting for United States Taxpayers – Form 5471

- **Form 5471 – look to 10% or greater interests in foreign corporations**
  - Filed by United States taxpayers with specified interests in foreign corporations
    - Category 2 filer – U.S. individual who is an officer/director in a foreign corporation where U.S. shareholder acquires/disposes of 10% interest
    - Category 3 filer – U.S. taxpayer acquiring/disposing of 10% interest
    - Category 4 filer – U.S. taxpayer with control over a foreign corporation
    - Category 5 filer – U.S. shareholder of a controlled foreign corporation
  - Duplicative reporting eliminated for U.S. taxpayers with reporting requirements for the same corporation in the same category

Reporting for United States Taxpayers – Form 8865

- **Form 8865 – look to (1) 10% or greater interests in foreign partnerships or (2) significant contributions to a foreign partnership**
  - Filed by United States taxpayers with specified interests in foreign partnerships
    - Category 1 filer – U.S. taxpayer who controlled a foreign partnership during the year
    - Category 2 filer – U.S. taxpayer owning a 10% interest in a foreign partnership controlled by U.S. taxpayers
    - Category 3 filer – U.S. taxpayer contributing to a foreign partnership if (1) she owned more than 10% of the foreign partnership after contribution or (2) the contribution exceeds $100,000
    - Category 4 filer – U.S. taxpayer whose interests in a foreign partnership increases/decreases by 10% in a given year

Reporting for United States Taxpayers – Additional Requirements

- **Form 5472 – filed by United States corporations owned 25% or more by foreign taxpayers**
  - Filed by reporting corporations which have reportable transactions with foreign or domestic related parties
- **Form 8858 – filed by United States tax owners of foreign disregarded entities**
- **Form 926 – filed by United States persons making covered transfers to foreign corporations**
- **Forms 1116/1118 – filed by United States individuals/trusts/estates (Form 1116) and corporations (Form 1118) to claim foreign tax credits**
  - Separate categories/baskets used for foreign tax credits
- **Form 2555 used to claim foreign earned income exclusion**

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