

AMERICAN CHAMBER OF COMMERCE IN AUSTRALIA

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November 1999

Mr John McWilliam
Assistant Secretary
International Branch
Department of Family & Community Services
Box 7788
Canberra Mail Centre ACT 2610

Dear Mr McWilliam

The American Chamber of Commerce in Australia and the Australian firm of PricewaterhouseCoopers are pleased to be able to make a submission to assist in the discussions taking place between the Australian and United States Governments in relation to Social Security and pension/superannuation issues. We understand that the aim of the discussions is to possibly negotiate a totalisation agreement between the two countries.

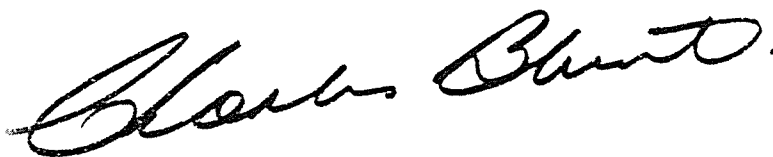
We should therefore like to take this opportunity to bring several matters to your attention prior to your initial meeting on 15 November 1999, to assist the meeting and discussions to focus on certain matters which we believe need to be addressed.

We understand that the purpose of the discussions is intended to relate to *social security* issues. However, since Australia does not have a separate and distinct social security tax, we believe that, for the purposes of these discussions, the compulsory contributions to Australian superannuation funds result in a quasi social security tax, which may be compared to the US social security tax system. Since the US and Australian tax treatment of private retirement plans accumulating contributions and paying benefits, extends beyond the liability to make the initial contributions, we have included in our discussions below other related issues where double taxation or other anomalies currently exist.

If you would like us to attend any consultations to discuss the issues raised in our attached report, we would be pleased to do so.

If you have any questions with regard to the enclosed, please do not hesitate to contact the undersigned or Mike Forsdick or Helen Cudlipp of the Sydney office of PricewaterhouseCoopers. Contact details are shown in the attached report.

Yours sincerely



Charles W Blunt
National Director



Charles W. Blunt
National Director

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AMERICAN CHAMBER OF COMMERCE IN AUSTRALIA
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Social Security Totalisation Agreement between The United States of America and Australia

A joint submission to the
US and Australian Governments by
The American Chamber of Commerce in
Australia and PricewaterhouseCoopers

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Background

As you are aware, there are many transfers of employees of US and Australian companies between the two countries. Our information and extensive experience indicates that this exchange of personnel has increased quite significantly in recent years, and looks likely to continue to increase in future years.

In most cases, our information indicates that a typical 'assignment' in either direction does not last longer than three to four years, with the overwhelming majority of expatriate employees returning to their home country on completion of their assignment. This paper will also address issues affecting those individuals transferring on a more permanent basis.

Both countries have, over time, introduced specific rules and regulations to encourage employees and self-employed individuals to provide for their own retirement. Although the specifics of each country's requirements and the tax treatment are different, the basic principles are the same, i.e. encouraging, with appropriate tax incentives or concessions, individuals to invest in specific funds or products to generate personal retirement benefits, with the aim of reducing the number of people dependent on government schemes. However, to date, despite the many similarities in these basic principles, neither Australia nor the United States has recognised the other country's systems from a taxation perspective.

As a result there are currently a number of anomalies in relation to retirement payments between the two countries and instances where additional costs are incurred (without any future benefit to the employee or his/her employer) and/or double taxation arises.

We would therefore like to take this opportunity to raise some of these issues so that they may be considered in your mutual discussions, even though some of the issues raised may go beyond the scope of the initial planned discussions.

Executive Summary

We have set out below a summary of the key areas which we believe need to be addressed, and our recommendations as to how the issues arising could be remedied, particularly for those employees on temporary assignments between the United States and Australia. It is our belief that our recommendations would not create significant additional administration for either country, once the parameters of the Agreement have been identified and established.

Synopsis of recommendations

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- Extension of the exemption from the Australian Superannuation Guarantee Charge (SGC) to **all** temporary visa holders from the United States and not just those who qualify as 'managerial and executive';
 - Confirmation of recognition by Australia of US Section 401(k) funds and Keogh plans as being 'corresponding' to Australian superannuation funds and therefore not taxing current contributions to such funds;
 - Recognition by Australia of US Individual Retirement Accounts ('IRA's'), as being corresponding to Australian Approved Deposit Funds ('ADF's') and other rollover funds, and therefore not taxing the income generated within such funds;
 - Recognition by both countries of each other's retirement systems and the ability to roll over benefits from one fund to another both within and across to each country without incurring tax.
 - Abolition of the requirement for Australian employees working temporarily in the United States, and their employers, to make contributions to the US Social Security system (FICA/Medicare);
 - Recognition by the United States of the Australian superannuation system as a 'corresponding' system, such that employer contributions to Australian superannuation funds and income generated within such funds are not considered to be current taxable income for US tax purposes;
 - Recognition by the United States of Australian Approved Deposit Funds (ADF's) and other rollover funds as being 'corresponding' to US Individual Retirement Accounts (IRA's) and therefore income generated within such funds not being considered current taxable income for US tax purposes;
- Presenta

We have set out below a more detailed description of the current situation and the issues that currently arise for international transfers between the United States and Australia. We have also briefly described our recommendations for appropriate remedial action in relation to each issue.

1. Superannuation Guarantee Charge ('SGC')

The SGC is levied in respect of all individuals working in Australia, with the exception of certain temporary visa holders (Temporary Residence visas sub-class 456 or 457, who qualify as 'managerial and executive'). The compulsory contributions are currently set at 7% of compensation (up to a maximum annual salary of A\$100,960 for the year ending 30 June 2003). This is due to increase to 9% with effect from the 2002 year. These contributions are generally paid into private sector superannuation funds, and result in private funding of retirement benefits as opposed to Government funding.

An SGC requirement exists for Australian tax resident and non-resident employees for work done in Australia, regardless of the location of the employer.

In the overwhelming majority of cases, there is no intent for the employee to remain in Australia long-term, and the employee will ultimately retire in the United States with no further connection to Australia.

In circumstances where the employee is working temporarily in Australia, it is usually the case that the employee remains on the US payroll, and also continues to participate in the US employer's benefit plans. In addition, as a US employee, both the individual employee and his/her employer are required to continue to contribute to the US social security system.

In the overwhelming majority of cases, there is no intent for the employee to remain in Australia long-term, and the employee will ultimately retire in the United States with no further connection to Australia. This is typically true of most temporary visitors from the United States (and other countries) regardless of whether the employee is 'managerial and executive' or entering Australia, for example, as a technician on a special project with specialist skills or on a short term training assignment.

The requirement to make contributions under the SGC for such temporary visitors amounts to double taxation.

The requirement to make contributions under the SGC for such temporary visitors does amount to double taxation, since there is no ability to obtain exemption from the US requirements for social security tax payments. Since most employees intend to return to the United States to ultimately retire, their preference is also to maintain their contributions to US company retirement plans and therefore maximise their retirement benefits in their home country.

Although the benefits accumulated from the SGC may be accessible upon ultimate retirement, the amount of benefit is usually nominal (for example, the current gross contribution for someone on the equivalent of A\$50,000 salary per annum and in Australia for 3 years would be A\$10,500, before taking into account the contributions tax, etc). Upon eventual retirement, this amount may well have been eroded by fees and other charges, or the employee may have lost contact with the fund, in which case the benefits return to the Australian government under the 'lost member' regulations.

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The current approach is a source of considerable irritation for US expatriate employees and their employers and can add to the view that Australia is a high tax environment, and a disincentive to investment and business.

Since the employee does not generally see the benefit of the SGC (either currently or as a future benefit), the cost of the SGC is generally borne by the employer, on top of the US retirement plan and social security costs, and is viewed as yet another additional detrimental cost of doing business in Australia. The current approach is a source of considerable irritation for US expatriate employees and their employers and can add to the view that Australia is a high tax environment, and a disincentive to investment and business. We believe the benefits of modifying the current arrangements to cover all 'exempt visitors' would be highly beneficial with no cost to the Government.

Additionally, any benefits generated from SGC contributions have preservation requirements and will therefore have to remain in Australia in an approved Australian fund until the individual retires from full-time employment after reaching the requisite retirement age, which may be as many as 40 years hence. In this situation (as for Australians working temporarily in the United States, refer below) the accumulation of benefits in the Australian fund is assessable currently as income to the individual in his/her US income tax returns, with only possibly minimal credit for the Australian taxes paid at the time of contribution or by the fund on its earnings. In many cases, there is no credit allowed as the fund is liable for the Australian tax rather than the individual, and therefore the US does not allow any credit to pass through to the individual, despite assessing the contribution as taxable income.

Upon ultimate withdrawal of any residual benefits on eventual retirement, such benefits are deemed to have a source in Australia and are therefore currently always taxable in Australia where the benefits are withdrawn as a lump sum. The withdrawal of the benefits is subject to Australian income tax in accordance with the Australian tax rules at that time, ***without any recognition for the US tax that would have been paid either at the time of contribution or on the earnings of the fund throughout its 'life'.***

This is contrary to the general rules of the Double Taxation Treaty between the United States of America and Australia, but is not currently addressed in either country's domestic laws or the Double Taxation Treaty.

In summary, therefore, there is currently both US and Australian tax payable at the time of contribution to the Australian superannuation fund, and both US and Australian tax payable on the investment earnings of the fund/annual increase in vested benefits. Potential for further double taxation also arises when the benefits are withdrawn from the Australian superannuation fund. ***Under current arrangements, only minimal, if any, credit is allowed to offset this double taxation. This is contrary to the general rules of the Double Taxation Treaty between the United States of America and Australia, but is not currently addressed in either country's domestic laws or the Double Taxation Treaty.***

Again, this double taxation is generally recognised by many employers who operate tax reimbursement policies, with such costs being borne by the employer, again adding to their overall costs of doing business in Australia. Where the employee is not covered by such a policy, the additional tax costs in the United States have to be borne by that individual out of their own funds, since they do not have current access to the SGC benefits.

Extend the current SGC exemption so that it applies to all 'exempt visitors' (as defined in S. 517 of the ITAA of 1936) rather than a small sub-set of these.

We feel that there are several possible solutions, which are not mutually exclusive, to the above issues, namely:

- a. extend the current SGC exemption so that it applies to all 'exempt visitors' (as defined in S. 517 of the ITAA of 1936) rather than a small sub-set of these; or *→ ruled by Agreement*
- b. extend the SGC exemption so that it applies to all employees where offshore social security (US FICA/Medicare) or similar superannuation arrangements exist (US s.401(k) or US pension plan contributions are being made); or
- c. allow the equivalent of the SGC amounts in respect of appropriate employees to be paid into an 'approved' US retirement fund (e.g. US s.401(k) plan or equivalent) and thereby also avoid the current US taxation of the contributions; or
- d. amend the superannuation preservation rules to allow Australian superannuation benefits to be transferred (not withdrawn) tax free to an 'eligible non-resident superannuation fund' (specific definition to be agreed on) on permanent departure from Australia.

We believe that the general 'voluntary' preservation of benefits in the United States, combined with the US tax (including 10% penalty) treatment in the US for early withdrawal, will be a sufficient deterrent against the abuse of this relaxation of the preservation rules. From an Australian tax revenue perspective, we believe that the amount of overall revenue foregone would be minimal as the tax amounts generated by the amounts retained within the funds would on average be small, and in many cases no Australian tax would be payable on eventual retirement due to the tax-free threshold in existence for individuals aged at least 55. *→*

2. Exempt visitor status and Fringe Benefits Tax

It is very common for US expatriates to continue their retirement arrangements in the US whilst resident in Australia. Where a US expatriate employee is resident in Australia on a temporary residence visa valid for less than four (4) years (i.e. they are an 'exempt visitor'), contributions can continue to be made to a US retirement arrangement for that employee, either by the US company or the Australian employer, without any Australian personal income tax or Fringe Benefits Tax (FBT) implications. Upon eventual withdrawal of the benefits, US income tax is payable at that time (plus a 10% penalty if the benefits are withdrawn early, i.e. before the taxpayer reaches at least age 59½).

No tax deduction is available in Australia for the contributions if they are borne by the Australian employer (e.g. the contributions are either paid directly by or are recharged to the Australian employer). However, once the exempt visitor status is lost, any contributions to a foreign superannuation fund attract an FBT liability, whether borne by the Australian employer or not, based on the grossed up amount of the contributions.

However, for US tax purposes, any income tax is deferred until the benefits are actually withdrawn from the fund. Thus, where Australian FBT is charged at the time the contributions are made, double taxation arises.

Our information and experience indicates that the majority of employees working in the United States would have accumulated benefits in s. 401(k) plans or similar arrangements, and consider the continuity of these of extreme importance in their total remuneration and retirement planning arrangements.

In order to combat any current inequity, we suggest the following courses of action:

Consideration should be given to extending the 'exempt visitor' status beyond the current four year period

On permanent departure from Australia, any superannuation benefits accumulated in an Australian fund could be transferred to a US fund.

- a. In certain circumstances, where an individual's intention is not to become a permanent resident of Australia, consideration should be given to extending the 'exempt visitor' status beyond the current four year period such that no Australian tax is payable on the contributions (either personal income tax or FBT) and contributions to the US plan are deductible to the Australian employer, within appropriate limits;
- b. As stated above with regard to the SGC, if the preservation rules were updated, on permanent departure from Australia, any superannuation benefits accumulated in an Australian fund could be transferred to a US fund. This would mean that, while in Australia, contributions could be made to an Australian complying fund whilst the individual was an Australian resident, thus avoiding the FBT issue. This would, however, only be attractive to US employees if the US tax treatment of the Australian contributions was amended such that no US income tax was payable on the contributions, i.e. the contributions were truly treated in the same manner as US contributions (refer also below).

3. Australian tax treatment of US Individual Retirement Accounts ('IRA's')

A US IRA may be used by US citizens and residents for three primary purposes:

- a. to hold benefits rolled over from a previous US employer's retirement plan / S. 401(k) fund upon termination of employment with that employer, until eventual retirement;
- b. to hold additional employee contributions for retirement purposes (usually supplementary 'after-tax' contributions);
- c. to accumulate nominal amounts for retirement purposes for a non-working spouse.

The US Internal Revenue Code allows benefits to be rolled over from a US retirement fund and/or employer's s. 401(k) plan into an IRA (specifically defined in US legislation) without incurring US income tax, assuming that the rollover occurs within a specified time period and in a specified format, similar to the Australian rollover provisions from one qualifying superannuation fund to another superannuation or rollover fund.

For US tax purposes, an IRA is a tax-deferred arrangement and no US income tax is payable until eventual withdrawal of the accumulated benefits, at which time US income tax is payable on the taxable component of the benefits (generally the full amount of the benefits less any 'after-tax contributions') at the taxpayer's marginal tax rate. Should such a withdrawal occur prior to the taxpayer reaching age 59½, an additional penalty is incurred for early withdrawal, equivalent to 10% of the amount withdrawn.

From an Australian tax perspective, however, the current system does not recognise the retirement fund nature of IRA's and any income generated within the IRA is currently taxable in Australia, despite being tax-deferred for US tax purposes.

As a result, as their name implies, these accounts are used to specifically accumulate retirement benefits for US citizens and residents. Our information indicates that the majority of the US working population would have at least some benefits accumulated in an IRA.

From an Australian tax perspective, however, the current system does not recognise the retirement fund nature of IRA's and any income generated within the IRA is currently taxable in Australia, despite being tax-deferred for US tax purposes. Since no US income tax is currently payable on the income within the IRA, no US foreign tax credits are available to offset the Australian tax liability. Upon ultimate withdrawal of the benefits, US income tax is payable, and, since a) the income is US sourced income and b) the withdrawal will usually occur many years after the taxpayer was resident in Australia, there is no ability to claim any credit for the Australian taxes paid previously. Again, this amounts to double taxation.

In addition, these funds may be regarded as Foreign Investment Funds (FIF's) and a resident taxpayer who is not an 'exempt visitor' may be assessed in Australia on the increase in value of the fund each year (excluding contributions). If the IRA fund is significant (e.g. because of the rollover of benefits from a previous employer), the tax liability arising from a simple extension to an Australian work visa to beyond four (4) years can be substantial.

We suggest the following actions be considered:

*Australia should
recognise the tax-
deferred treatment of
IRA's and their frequent
use as a rollover
depository for retirement
monies and grant
'corresponding approval'*

- a. Australia should recognise the tax-deferred treatment of IRA's and their frequent use as a rollover depository for retirement monies and grant 'corresponding approval' to them accordingly. No Australian tax should be payable on the income generated within the IRA's until such time as the accumulated benefits are withdrawn. If this withdrawal occurs while the employee is still a tax resident of Australia, then the taxing point in both the United States and Australia would be the same, and appropriate credits would be allowed to prevent any double taxation.
- b. A specific exemption could be included in the Australian FIF legislation to exclude any IRA's from possibly being regarded as FIF's, i.e. an extension to the current specific exemption for foreign employer-provided superannuation funds.
- c. As above, if a specific exemption from the FIF legislation is not available, an extension to the exempt visitor status beyond 4 years could be granted in appropriate circumstances to prevent IRA's becoming assessable under the FIF rules.

4. Section 27CAA ITAA 1936

Under s. 27CAA of the Australian Income Tax Assessment Act, any lump sum payment from a non-resident superannuation fund, in relation to a resident taxpayer, attracts a tax liability based on the increase in member's benefits (excluding contributions), at least to the extent derived during a period of Australian residency.

This definition is sufficiently wide that it catches the transfer of benefits from one fund to another, even if this is from one foreign employer-sponsored superannuation fund (or equivalent) to another, which clearly appears inequitable

This definition is sufficiently wide that it catches the transfer of benefits from one fund to another, even if this is from one foreign employer-sponsored superannuation fund (or equivalent) to another, which clearly appears inequitable. An exemption is granted for transfers made within six months of the date that residency commenced, where the benefits relate entirely to a period of service while a non-resident of Australia. From a US tax perspective, qualifying rollovers from one retirement fund to another within the United States are tax-free, with US income tax only being payable upon ultimate withdrawal of the benefits.

The transfer of benefits (either to another foreign fund or to an Australian fund) outside the initial six months of Australian tax residence may therefore result in an Australian tax liability for the individual concerned. In cases where an individual coming to Australia on a temporary basis subsequently decides to remain here permanently, that decision to remain here will more than likely not be made until after the six months exemption window has already expired.

Under the current treatment, the individual will need to pay any Australian tax liability which arises out of other funds, as the full amount of retirement benefits may have been rolled over and not be accessible. Since US income tax will be payable in the future, the payment of Australian income tax at the time of any rollover amounts to double taxation.

The Australian Government should therefore consider the following changes:

Transfers from a foreign superannuation fund to another foreign fund should not give rise to Australian tax.

- a. Amend s. 27CAA of the Australian Income Tax Assessment Act so that transfers (i.e. rollovers, not withdrawals) from a foreign superannuation or equivalent fund (e.g. US s. 401(k) plan) to another similar foreign fund do not give rise to an Australian tax charge on the individual. In the event that the taxpayer actually withdraws the benefits from the foreign superannuation fund while resident in Australia, then Australian tax would be payable on the increase in the benefits from the date of ceasing to be an 'exempt visitor', but since such a withdrawal would also give rise to a US income tax liability, appropriate foreign tax credits would be available to prevent any double taxation.

in the event that benefits are transferred from a US superannuation or equivalent fund into an Australian complying fund, the following taxing events would occur:-

- Benefits accrued in the US plan up to the date of ceasing to be an 'exempt visitor' would be:

- Subject to US tax
- Free of Australian tax as undeducted contributions

- Benefits accrued in US plan after ceasing to be an 'exempt visitor' would be:

- Free of US tax
- Subject to Australian tax as a taxable contribution (but not surchargeable)

Our recommendation is that contributions to a US plan be deductible for Australian corporate tax purposes for 'exempt visitors'.

This is consistent with our recommendation that contributions to a US plan be deductible for Australian corporate tax purposes for 'exempt visitors'.

This would appear to be a fair treatment for benefits accrued after ceasing to be an 'exempt visitor', treating them effectively as contributions to a complying Australian superannuation fund. Contributions tax would be deducted from the benefits rather than the individual having to fund the tax liability through other means. These contributions to the Australian superannuation fund will then be subject to the normal Australian Reasonable Benefit Limit/Eligible Termination Payment rules on eventual withdrawal.

It should be noted, however, that equivalent transfers from a United Kingdom plan to an Australian plan are free from UK tax entirely.

From a US tax perspective, we recommend that consideration be given to the introduction of a 'transfer tax' on benefits accrued up to the date of ceasing to be an 'exempt visitor'. This would be deducted at the time that the benefits were transferred to an Australian complying superannuation fund. This would then ensure that the US was able to collect an appropriate amount of income tax at that time, similar to the amount that would have been collected on eventual pay-out of the benefits if the employee had remained in the United States. We would suggest, however, that no penalties be imposed if the individual has not reached age 59½ at the time of the transfer, on the basis that the benefits are being **transferred** rather than **withdrawn** and would now be subject to the Australian preservation requirements. Indeed, a flat rate of tax would simplify these arrangements, with recognition that the tax is being collected earlier than usual. It should be noted, however, that equivalent transfers from a United Kingdom plan to an Australian plan are free from UK tax entirely.

The above recommendation would ensure that, in the situation where a US citizen decides to remain permanently in Australia and transfers their accumulated US retirement benefits to an Australian fund, the benefits accumulated up to the date of the 'permanent' transfer would be subject to US income tax, and the benefits then transferred to the Australian fund. Subsequent benefits accumulating in the Australian fund would be subject solely to Australian tax. This appears to be an equitable solution to the current double taxation issue.

Extend the six month exemption so it is linked to the 'exempt visitor' status

- c. Extend the six month exemption in respect of lump sum transfers so that it is linked to the 'exempt visitor' status i.e. for a period of up to four (4) years (or possibly longer, as discussed above) while on a temporary residence visa in Australia, plus a **further** six months exemption to apply from the date that a permanent visa is applied for.

1. US Social Security Tax Obligations (FICA/Medicare)

These social security tax payments are required, regardless of the type of visa held.

Under the current legislation, any Australian employee working in the United States is required to pay US social security taxes in respect of their employment income. In addition, US employers are required to make 'matching' contributions. These social security tax payments are required, regardless of the type of visa held (permanent ('green card') or non-immigrant visa) and regardless of whether Australian superannuation contributions are continuing to be made on the employee's behalf while working in the United States.

The majority of employees on international assignment to the United States leave prior to achieving the minimum number of quarters of coverage.

Unless the employee contributes to the US social security system for a minimum number of quarters of coverage or 'QC's' (FICA contributions paid), the individual is currently not entitled to any benefits under the system. Thus, where the majority of employees on international assignment to the United States leave the United States permanently prior to achieving the minimum number of quarters of coverage, tax payments into the system have been made, but with no resulting benefit entitlement.

Tax payments have been made into the system with no resulting benefit entitlement.

Following the extension of the Medicare liability to total remuneration with no liability 'cap', the amounts required to be paid annually can be quite significant, since the 'remuneration' on which the liability is calculated will include many expatriate benefits and allowances. In recognition of the fact that the employee will in no way benefit from the contributions to the system, many employers will bear the cost of this additional burden on behalf of their employees, which in turn becomes a taxable benefit, thus increasing the employer's costs considerably.

It therefore appears inequitable that FICA/Medicare taxes are payable by Australian expatriate employees working in the United States when no benefits are or will be available.

The United States should allow an exemption from the requirement to make contributions under FICA and Medicare, where the employee does not intend to remain permanently in the United States.

We recommend that the United States recognise the SGC as a quasi 'social security tax'.

We therefore suggest that the following be considered:

In accordance with similar agreements entered into between the United States and other foreign countries, the United States should allow an exemption from the requirement to make contributions under FICA and Medicare (social security taxes) for both individual Australian employees and their employers (whether US or Australian), where the employee does not intend to remain permanently in the United States. This could be tied to a period where the employee remains on a non-immigrant visa, and states an intention to return to Australia upon completion of their temporary US assignment.

In the event that an employee does intend to remain in the United States on a longer term basis, contributions would be required to be made to the US social security tax system (and would also be in the employee's personal interest) as of the date that that intention was known. However, any period of service in the United States where exemption from the liability to make social security tax payments had been granted, would not be taken into account in determining any future entitlement to any benefits under the US social security tax system.

2. If a total exemption from the US social security taxes in the circumstances noted above is not considered appropriate, we would recommend that exemption be granted as above, where contributions of a similar nature continue to be made in Australia.

As discussed above for US employees working in Australia, the Australian Superannuation Guarantee Charge ('SGC') is essentially a contribution towards the cost of providing retirement benefits and it normally also includes a 'death and disablement' component. We therefore recommend that the United States recognise the SGC as a quasi 'social security tax'. If an Australian expatriate employee seconded to work in the United States, continues to have employer (and deemed employer) contributions made to an Australian complying superannuation fund, at least equivalent to the SGC rate, an exemption should be available from making FICA/Medicare tax payments (both employee and employer).

In the event that such an individual were to then decide to permanently settle in the United States, FICA and Medicare taxes, for which an exemption had previously been granted, would become payable from the date of change of intention. Retirement benefits applicable to the period up to that date would be fully provided by the benefits accumulated within the Australian superannuation fund.

2. US tax treatment of Australian superannuation funds

Although contributions by Australian employers into Australian superannuation funds are similar to contributions made by a US employer, the US tax treatment is different and results ultimately in double taxation.

As indicated previously, although contributions by Australian employers into Australian superannuation funds are similar in basic principle to contributions made by a US employer into a US s. 401(k) plan or retirement pension plan, the US tax treatment of both any continuing Australian fund contributions and the accumulated benefits for a US based employee is different and results ultimately in double taxation. This is because the contributions are viewed as additional employee remuneration by the Internal Revenue Service ('IRS') (and most State tax authorities), and an income tax liability arises to the individual employee.

From a US tax perspective, the employer (and any deemed employer) contributions to an Australian superannuation fund in respect of an employee performing services in the United States, form part of his/her taxable remuneration. Although the contributions are being made to an Australian fund, the source of the employment income is in the United States as this is where the employee's services are being performed. Thus, even if the United States were to allow a credit for the Australian taxes payable by the superannuation fund on the contributions (i.e. on a 'look-through' basis), no credit would actually be available as the income is US sourced.

This tax is payable by the fund and not by the individual member and therefore no credit is allowed to offset the US income tax payable.

In addition, increases in members' benefits (i.e. growth in the Australian superannuation fund) is also generally assessed as taxable income for US tax purposes in the year it is accumulated, while the member is a US tax resident (or a non-resident alien working in the United States). Although Australian tax is payable on the investment earnings of the superannuation fund, this tax is payable by the fund and not by the individual member and therefore no credit is allowed to offset the US income tax payable. This credit, if allowed, would also generally be insufficient to fully offset the US tax liability, since the Australian tax rate payable by the fund is limited to a maximum of 15%.

Any US income tax payable will need to be met by the individual member out of 'other' funds, since the benefits accumulating in the Australian superannuation fund are generally not accessible.

In both cases (i.e. on both the contributions and the investment growth of the fund), any US income tax payable will need to be met by the individual member out of 'other' funds, since the benefits accumulating in the Australian superannuation fund are generally not accessible. Where the employer operates a tax reimbursement policy, the additional US income taxes payable on these components will often be met by the employer, which in turn increases the employee's taxable income further. If the employee is 'on their own', then they will personally be liable for the US income tax payable out of their own funds.

Upon eventual withdrawal of the Australian superannuation benefits from the fund in a lump sum, Australian income tax is payable since the benefits are deemed to have a source in Australia. The Australian tax payable at that time will not take into account any US tax that may have been payable during a period when the employee was subject to US income tax. Thus, double taxation occurs.

The United States should recognise contributions to Australian superannuation funds and afford the same tax treatment as if paid into a US fund

Recommendation

- a. the United States should recognise contributions to Australian superannuation funds as retirement related and afford the same tax treatment as if paid into a similar-principled US fund (i.e. employer and deemed employer) contributions and the investment earnings of the fund should not be treated as assessable income until such time as the member withdraws the benefits).



3. US tax treatment of Australian rollover funds

As discussed above for the Australian tax treatment of benefits held in US rollover funds (IRA's in particular), the United States also does not currently recognise benefits held in Australian rollover funds, e.g. Australian Approved Deposit Funds ('ADF's') or personal superannuation funds.

The member would not have the intent or the ability to withdraw these benefits.

In general, benefits held in such funds would represent accumulated superannuation benefits from a prior employer, where these benefits had been rolled over from that prior employer's fund into another qualifying Australian fund until actual retirement. The member would generally not have the intent (or in most cases now, even the ability) to withdraw any of these benefits until he/she reaches appropriate retirement age and had indeed retired from full-time employment.

From an Australian perspective, these benefits **must** be retained in such a fund until the member is eligible to withdraw them at the appropriate retirement age.

The tax paid in Australia would not be sufficient in most cases to eliminate the US income tax payable.

As indicated, the United States does not currently recognise the tax-deferred status of these funds and currently seeks to tax the annual increase in value of the funds. Although, in this instance, some credit may be available for the Australian tax payable by the fund, the tax paid in Australia would not be sufficient in most cases to eliminate the US income tax payable.

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Since, again, upon ultimate withdrawal of the benefits, Australian income tax is payable (having also paid Australian tax at the original time of the contributions as well as on the investment earnings of the fund), this amounts to double taxation as again, no credit is allowed for US income taxes that may have been payable while the member was subject to US income tax.

The United States should recognise Australian rollover and personal superannuation funds as retirement related.

Recommendation

- a. the United States should recognise Australian rollover and personal superannuation funds as retirement related and afford the same tax treatment as a similar-principled US fund (i.e. the investment earnings of the fund should not be treated as assessable income until such time as the member withdraws the benefits).

4. Transfers of retirement benefits

Under the current US tax treatment, should an employee terminate employment with an Australian employer while resident in the United States, any Australian superannuation benefits accumulated within the Australian employer's superannuation fund may be subject to US income tax at that time, to the extent that they relate to the period of US tax residence and have not previously been taxed in the United States.

As there is no ability to withdraw these benefits, it is inequitable that US income tax should be assessed at this time.

Since, in most cases, any such benefits **must** be rolled over into another Australian company superannuation fund or into an Australian personal rollover or superannuation fund, i.e. there is no ability to withdraw these benefits, it is inequitable that US income tax should be assessed at this time.

As discussed previously, Australian income tax will be payable in the future when the benefits are ultimately withdrawn, without regard to the US tax paid previously.

Recommendation

- a. The United States to recognise the retirement nature of Australian superannuation and rollover funds and to afford the same tax treatment to Australian rollovers as is currently allowed for rollovers between US retirement and s.401(k) plans etc.

Conclusion

As can be seen from the above commentary, there are many similarities between the United States and Australia in the structure of employer and employee retirement plan contributions and the accumulation of benefits for retirement purposes.

Currently, both countries have legislated that such accumulation of retirement benefits should attract tax-deferral or tax concessions where such accumulation occurs for their domestic citizens and residents within specifically recognised domestic products.

With the ever-increasing exchange of personnel between the United States and Australia, predominantly for only temporary periods, the current domestic tax laws of each country penalise citizens and residents of the other country who have abided by the rules and regulations in accumulating retirement benefits.

It is our hope that, through the current discussions in relation to the establishment of a Social Security Totalisation Agreement between Australia and the United States, opportunities arise to effect changes to either the respective domestic tax legislation of each country or through the operation of such an Agreement that will eliminate many of the tax penalties that currently exist.

The aim of this submission is to highlight the areas of major concern to our members and clients where, in particular, double taxation arises and/or penalties apply which have the effect of individuals not being able to fully maximise their retirement benefit opportunities solely due to a period of temporary employment in the other country.

We believe that our recommendations for improving the current situation would not involve major loss of revenue to either country, and the administration to apply the recommendations would not be overly onerous once the basic principles of an agreement have been established.

Glossary of Terms and References

Term/Reference	Description
ADF's	Approved Deposit Funds
ETP	Eligible Termination Payment, as defined in the Australian ITAA
Exempt visitor	As defined in s. 517 of the Australian Income Tax Assessment Act
FICA/Medicare	US Social Security Taxes collected under the US Federal Insurance Contributions Act and US Medicare Act
FBT	Australian Fringe Benefits Tax
FIF	Australian Foreign Investment Fund legislation
IRA's	Individual Retirement Accounts
IRC	US Internal Revenue Code
IRS	US Internal Revenue Service
ITAA	Income Tax Assessment Act of 1936
Keogh plans	US Keogh plans as defined in the US Internal Revenue Code
RBL	Australian Reasonable Benefit Limit, as defined in the Australian ITAA
s. 401(k) plans	AS defined under S. 401(k) of the US Internal Revenue Code
SGC	Australian Superannuation Guarantee Charge
US/United States	United States of America

