

# U.S. Taxation of the Australian Super – **#DontMessWithTheSuper**

**“The Superannuation: The Decision To Renounce U.S. Citizenship”**

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An Historical Introduction: A legal discussion that is NOT a legal analysis



# Tax historian Charles W. Adams: As go taxes, so goes civilization!

*“Those are but a few of the facts that Charles W. Adams, a former California lawyer who is a research historian at the University of Toronto, has culled on the influence of taxes on history. ...*

*Mr. Adams says the Internal Revenue Service takes a leaf from the scribes of the pharaohs, who taxed almost everything. Sales, slaves, foreigners, imports, exports and business were all fair game. Snooping reached the point where scribes regularly inspected kitchens to make sure women were not using free drippings instead of the taxable oil they were required to use. Like Ice Melting”*

<http://www.nytimes.com/1993/10/03/weekinreview/conversations-charles-w-adams-rise-fall-civilization-according-tax-collection.html>

# Thinking about how taxation determines history?

**Invest** one hour in watching this interview with Charles W. Adams.

<https://www.c-span.org/video/?40556-1/good-evil-impact-taxes>

**Your return** will be that you will have a completely different understanding of taxation!

**As goes, tax policy so goes history!**

The present: Twas the night before Christmas, and I was reading ...



# Interview with “The Third Rail” co-author @JacquieMcNish

[https://www.youtube.com/watch?v=vCydwaHp\\_h4](https://www.youtube.com/watch?v=vCydwaHp_h4)

At the end of the book, she makes the point that:

**As goes tax policy, so goes the performance of pensions!**

# Pensions Matter – They are about national policy and citizen security

The Australian Superannuation is a FANTASTIC system (or at least better than all national pension systems except for Denmark and the Netherlands)!

For a ranking indicating how highly the Australian Superannuation is regarded, see:

<http://www.globalpensionindex.com/>

**The Australian Super is a model for the world. Not a pool of capital to be taxed by the United States of America!**



# It's Australian Citizen Security vs. The U.S. Internal Revenue Service



“We’re off to see the pension, the wonderful pension of Oz!”



# The Super: Different hopes for different folks!

## Issue of taxation of Australian Superannuation affects:

- *Homelanders abroad* – **The Scarecrow**
- *Australian citizens/residents living in the USA* – **The Tin Man**
- *Permanent residents and citizens of Australia* – **The Lion**
- *Having your OMG Moment* - **Dorothy**

**Do permanent residents who are citizens of Australia really need IRS permission to save for retirement?**

**Well, we are NOT in Kansas anymore!**

# Part 1 – When tax professionals disagree (or simply don't know)...

*“Superannuation is another area where compliance choices may end up dictating the treatment expected by the IRS. There are several different ways that superannuation can be analysed in determining how (or whether) to report super on a US tax return. In some ways, super is similar to US Social Security:”*

## **“When Tax Professionals Disagree”**

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree/>

# The context influencing “how MOST U.S. tax professionals think” ...

The world according to the “tax professional”. There are **ONLY two groups** affected:

1. Australians who move to America, arriving with a “personal pension abroad” – **Focus on mobility!**
2. Americans who move to Australia – AKA – “Homelanders Abroad” who take the “unusual step” of creating a “personal pension in Australia” – **Focus on mobility!**

**They do NOT see this from the perspective of “citizens of Australia who are – NOT MOBILE - just residing in Australia!”**

# You CANNOT allow the “tax professionals” to invent the law

*“I have long been of the opinion that (1) U.S. tax law is primarily enforced by the tax compliance community and (2) sooner or later the positions adopted by a “critical mass” of tax professionals WILL become the the law! This is why it’s extremely important that dual Australian/U.S. citizens in Australia understand that there ARE different perspectives on all of these issues including the Australian Superannuation issue.”*

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree/#comment-195>

# Australians can learn from the mistakes of Canadians ...

Many Canadian citizens allowed the “tax professionals” to interpret the U.S. tax treatment of Canadian investment and retirement planning vehicles.

Although understandable, this was a VERY great mistake that they VERY MUCH REGRET TODAY!

**Read why here:**

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree/#comment-213>

# If the tax professionals can't justify their interpretation, then ...

Australian citizens who are resident in Australia should interpret the “possible” U.S. taxation of the Australian Superannuation THEMSELVES – **in any defensible way.**

**You** certainly **don't know** for sure.

The **tax professionals** certainly **don't know** for sure.

The **IRS doesn't know** for sure.

**Conclusion: It would be a great mistake to allow “the blind to lead the blind!”. You may be blindly led to a disaster!**



# The IRS is ALSO uncertain about the treatment of Superannuations

*“The other day our tax lawyers posted the materials we have received so far in response to our FOIA request regarding Australian Superannuation accounts and other foreign retirement plans. ... These emails indicate that at least through early 2015 some IRS personnel, including those who were presumably in the best position to understand the intricacies of foreign retirement plans still had many questions.”*

<https://www.taxproblemattorneyblog.com/2016/03/even-irs-confused-australian-superannuation-accounts.html>

# Part 2 – The possible impact of the “Tax Treaty” on Superannuation

## What tax treaties are for ...

*“ ... tax treaties are limited cessions of the fundamental notion of source jurisdiction sovereignty.”*

- Professor Russell K. Osgood – page 259

<http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1138&context=cilj>

## What tax treaties are NOT for ...

They are **NOT** to allow the United States, **through the “savings clause”** to impose direct taxation on the citizens and residents of other nations!

# The “savings clause” – what’s that?

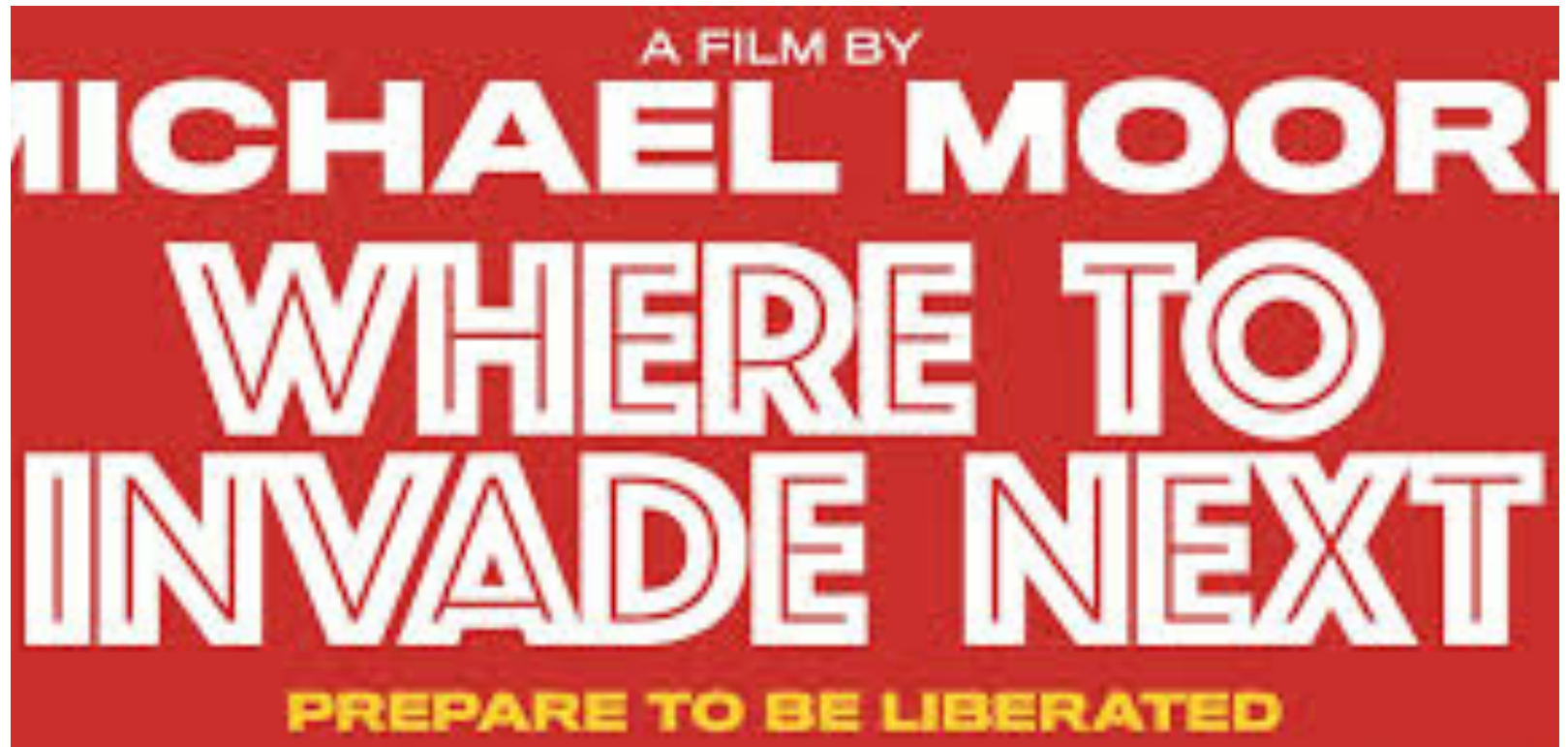
Article 1 (3) of the U.S. Australia Tax Treaty allows the USA to impose taxation on it’s **“citizens” (as defined by the U.S.)** without allowing them any benefits of the Tax Treaty.

In other words, Americans abroad do NOT get the benefit of the Tax Treaty.

By so doing, it also allows the USA to impose taxation on Australian citizens who are resident in Australia as though the Treaty does NOT exist.

<http://www.citizenshipsolutions.ca/2016/05/26/savings-clause-in-us-tax-treaties-guarantees-us-right-of-taxation-on-residents-and-citizens-of-other-nations/>

“savings clause” = invade, impose tax on residents of other nations



# Can the U.S. Australia Tax Treaty and SSTA Agreement really mean ...?

*'... the Treaty can be interpreted to mean that: "Australian citizens residing in Australia cannot save for retirement"!*

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree/#comment-195>

Comment from the post "**When tax professionals disagree**" at the "FixTheTaxTreaty.org" blog:

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree>

“When tax professionals disagree,  
it’s often a question of ...

**Are the tax professionals asking the right questions?**

U.S. tax professionals are trained to think about how the Internal Revenue Code of the United States of American rules the lives of all Americans! **This is NOT a criticism!**

**It never occurs to many of them that the United States Internal Revenue Code might not apply at all!**

The thought of the IRC not applying  
“short circuits” their brains



# To a hammer, everything looks like a nail ...

To a U.S. tax professional the whole world is to be analyzed through the Internal Revenue Code!

**From a U.S. tax perspective is the Australian Superannuation:**

- **A foreign grantor or nongrantor trust?**
- **An employee trust under Internal Revenue Code 402?**
- **What Forms: 3520, 3520A, 8938, 8621, Mr. FBAR, etc ...**

**If it doesn't fit, then "By God" we will make it fit!**



It all comes back to the Greek Myth of Procrustes – Cut off legs to fit bed!



# But, wait! Maybe The Tax Treaty means the IRC doesn't apply at all!

The August 5, 2016 decision by Justice Millet of the United States Court of Appeals in the Eshel case confirmed that the “**expectation of the parties to the treaty**” is a relevant (actually the most relevant) consideration in the interpretation of the Treaty.

<http://www.citizenshipsolutions.ca/2016/08/07/the-interpretation-of-us-tax-treaties-domestic-law-foreign-law-or-the-intent-of-the-treaty/>

# At least two questions about the “expectations of the parties” ...

1. Could the U.S. Australia Tax Treaty EVER have been interpreted to mean that Australian citizens, who are resident in Australia should have their retirement planning in general and the Superannuation in particular, be regulated by the Internal Revenue Code? **I think NOT!**
2. Could the “Savings Clause” (as a general principle) possibly be interpreted to mean that Australia agrees that the U.S. ALWAYS has the right to impose U.S. taxation on Australian citizens resident in Australia? **I think NOT!**

<http://www.citizenshipsolutions.ca/2016/05/26/savings-clause-in-us-tax-treaties-guarantees-us-right-of-taxation-on-residents-and-citizens-of-other-nations/>

# Expectations: For “savings clause” can the U.S. define “U.S. citizen”?

## Think about it:

1. Can the USA define and redefine the definition of “U.S. citizen” (expanding it’s tax base) whenever it wants?
2. Note that the U.S. Australia U.S. tax treaty was signed well before the advent of the “U.S. tax citizen” in 2004 and the S. 877A rules in 2008 and before the Super!

**What is the “scope” of the “savings clause”?**

# In fact, the U.S. Australian tax treaty was signed in 1982 which is before

- PFICs (created by the USA in the 1986 tax reform)
- The 1986 amendments to the U.S. Immigration and Nationality Act making the scope of U.S. citizenship more evident
- The Australian Superannuation which was created in 1992
- The U.S. creation of the “tax citizen” in 2004
- The U.S. creation of the “Exit Tax” in 2008
- The FBAR Fundraiser which began in 2009
- The creation of FATCA and enhanced reporting requirements in 2010

# Was it the expectation of the Australian Government in 1982 that

- The United States of America could confiscate the wealth of an Australian citizen residing in Australia on the ground that he was an Australian citizen who was “Born In The USA”?
- That Australian citizens, residing in Australia, minding their own business. could be disabled from benefitting from Australia’s National Pension System?

**Not a chance!!!**

**But, that’s exactly what’s happening today!**

# Update – February 2017: Saving Australians from the “savings clause”

“Explaining the Saving Clause III” – FixTheTaxTreaty.org

<http://fixthetaxtreaty.org/2017/01/29/explaining-the-saving-clause-iii/>

**Three proposals to protect Australians from the U.S. Internal Revenue Code:**

- Remove the Saving Clause from the treaty (or exclude citizenship from the Saving Clause).
- Add a Citizenship “Tie-breaker” Clause.
- Add a “Tax Base Preservation” Clause.

# The 2016 U.S. Treasury Model Tax Treaty – HELPFUL and HOPEFUL ...

Article 17 of the 2016 Model Treaty appears to exempt both pensions and Social Security from U.S. taxation.

Furthermore, sections 2, 3 and 6 are NOT affected by the Savings Clause.

**Very important!!** It is the current intention of the United States that Treaties should be interpreted to exempt Australian pensions and Social Security from U.S. taxation.

<https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf>



# Today: Combined effect of current treaty and Totalization agreement ...

- Is interpreted by some to mean that the Superannuation (as defined below) is not subject to the Internal Revenue Code.
- Again, there is no consensus but this is a **possible** interpretation
- Various tax professionals (**rightly or wrongly**) are currently taking this position!

Citizens of Australia should NOT allow the “Tax Professionals” to **DEFINE** the issue: **#DontMessWithTheSuper**

## Part 3 – But, wait a minute: What do you mean by “Superannuation?”

**“Not all Superannuations are the same!”**

**The correct question is NOT:**

*“How does the Internal Revenue Code” apply to the Australian Superannuation?”*

**The correct question (if you agree the IRC applies at all) is:**

*“How does the “Internal Revenue Code” apply in different ways to the differing factual variants of the Superannuation?”*

<http://fixthetaxtreaty.org/2016/12/04/when-tax-professionals-disagree/#comment-195>

# Two main types of Superannuation

**CONCESSIONAL**

*(Before Tax)*

**NON-CONCESSIONAL**

*(After Tax)*

# By Superannuation I mean: Concessional – Before tax

- Basic Superannuation that is not self-managed
- Including salary sacrifice

**Easiest to argue that this version is the equivalent of Social Security**

# By Superannuation I do NOT mean: non-concessional “after tax”

**Because these are NOT government mandated it's harder to argue that they could be “Social Security”**

- If NOT “Social Security” then they are possibly a “grantor trust” under U.S. tax law

## **U.S. Grantor Trust status means:**

- U.S. Income attribution and taxation on the growth
- **Form Hell:** forms 3520, 3520A, 8621, 8938, FBAR and who knows what else!

**If you are a “U.S. Person”, consider avoiding the “non-concessional Superannuation” Your “USness” may disable you from every benefit of the “non-concessional” contribution.**

## Part 4 – Arguments for why the Superannuation is treaty protected

Combined effect of Tax Treaty (allocates taxing rights) and the Social Security Totalization Agreement (allocates contribution obligations) is that it:

- *“May” be interpreted to mean that the Superannuation (as defined below) is not affected by the Internal Revenue Code.*

**There is no consensus (arguments on both side of the issue) but this is a possible interpretation!**

***“Even when the the experts all agree, they may well be mistaken.” – Bertrand Russell***

## Part 5 – If not treaty protected, then what is IRC tax treatment?

1. How are the contributions taxed? Income at all? How does Internal Revenue Code S. 83 apply? Does S. 402 apply?
2. How is the growth inside the Super taxed?
3. How is the Super taxed on distribution?
4. Is tax paid in Australia available as a credit against possible U.S. taxes?
5. PFIC and Form 8621 considerations?

**Bottom line: Sooner or later, this spells trouble for “U.S. persons!”**

# IRC tax treatment of Superannuation: So many questions, no clear answers

**All kinds of different thinking among tax professionals which includes:**

- Employee trust under Internal Revenue Code S. 402
- Grantor Trust with all the attendant problems of tax and reporting requirements
- Nongrantor trust
- income under IRC S. 83?

**Key points:** For U.S. tax purposes the contributions and distributions are taxable. The growth while inside the Superannuation ...?



# There are NO clear answers and no consensus in the tax/legal community

## How can this be? The reasons include:

- there are so many different factual variants that are labeled “Superannuation”
- Because there are many different factual variants one **CANNOT** treat all variants the same way for U.S. tax purposes

Therefore, a clear answer is **NOT possible** to the general question:

**“How is the Superannuation taxed under the U.S. tax law?”**

# The significance of “no clear answers” and “no consensus” is ...

- You need to analyze your situation yourself and decide the appropriate U.S. tax treatment of the investment product you hold and that Australia calls your “Superannuation”
- **Warning! Warning!** The tax treatment of your most important retirement asset is too important to be left in the hands of the tax and legal community!

**Bottom line: Do NOT allow the tax and legal community to (in a sense) “create the law” by deciding this issue! Do they care about you?**

Nobody cares as much about your investments as you do!

*Nobody cares how much you know, until they know how much you care.*

Theodore Roosevelt

A glowing jellyfish with a pinkish-purple bell and blue tentacles is visible in the bottom right corner of the blue background.

## Part 6 – What about the IRC reporting requirements (and penalties)?

**If the Super IS Treaty protected and interpreted to be Social Security and NOT subject to IRC taxation, then ...**

- No particular reporting obligations (Form 8938 exempts Social Security)

**If the Super is NOT treaty protected and subject to IRC taxation then ...**

- **Form Hell:** 3520, 3520A, 8621, 8938, FBAR, possible 8833 and maybe more ...

# The Australian Superannuation reporting: Form 8938

## **Current directions to Form 8938:**

- If Social Security then not “foreign financial asset” and NOT reportable on Form 8938
- If NOT Social Security but some kind of pension, deferred compensation plan, or other financial asset then it IS reportable on Form 8938

**Note that this is very significant in terms of “tracking assets” for expatriation! Assets on Form 8938 are potentially subject to the S. 877A “Exit Tax” rules!**

# Part 7 – How is the Superannuation dealt with on Form 8854?

**Is it a “deferred compensation plan” or other kind of asset? – Exit Tax applicable**

**Deferred Compensation Plan:** Present value subject to full INCOME inclusion as part of “Exit Tax” confiscation

**Financial Asset that is NOT “deferred compensation:** Subject to the “mark to market” capital gains taxes

**Is it “social security”? – “Exit Tax” possibly NOT applicable**

Presumably NOT subject to inclusion on balance sheet as part of net worth because “Social Security” not treated as a “foreign financial asset”.

**The stakes on the proper characterization of the Australian Superannuation are VERY high!**

<https://www.irs.gov/pub/irs-pdf/f8854.pdf>

# If “deferred compensation” – 877A (d): Subject to full income inclusion

## How the confiscation of your Australian pension works

- (i) with respect to any deferred compensation item to which clause (ii) does not apply, an amount equal to **the present value** of the covered expatriate’s accrued **benefit shall be treated as having been received by such individual on the day before the expatriation date** as a distribution under the plan, ...

<https://www.law.cornell.edu/uscode/text/26/877A>

# Property deemed sold – S. 877A: Subject to deemed capital gains tax

## How the confiscation of your Australian Superannuation works

(a) General rules For purposes of this subtitle— (1) Mark to market All property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value.

<https://www.law.cornell.edu/uscode/text/26/877A>



# Remember: When it comes to the Australian Superannuation ...

**Not all “Superannuations” are the same!**

**Different kinds of Superannuation plans may be taxed differently (or not at all) on expatriation!**

**Which brings us to the Form 8854 balance sheet ...**

# Part V – Form 8854 Balance sheet

**The Part V Balance sheet: Different options for different Superannuation types**

Line 7:

**Pensions performed from services outside the United States**

Line 9:

**Assets held by trusts you own under Internal Revenue Code sections 671 – 679**

Line 19:

**Other assets**

# Form 8854 Balance Sheet – Part V asks you to specify

**Q.** How is the Australian Superannuation to be characterized?

**A.** It probably depends on the type of Superannuation.

**“Because, Not all Superannuations are the same!”**

# How does YOUR Super bear on your decision to renounce U.S. citizenship?

## Are you a “covered expatriate?”

If the Australian Superannuation is NOT “Social Security” and you are subject to the S. 877A “Exit Tax” (“covered expatriate”) then:

*Renouncing U.S. citizenship will lead to possible U.S. confiscation of part of your **Australian Superannuation (unless you have the benefit of the dual citizen FROM BIRTH exemption)!***

<http://www.citizenshipsolutions.ca/2015/04/01/renouncing-us-citizenship-how-the-s-877a-exit-tax-may-apply-to-your-canadian-assets-5-parts/>

**How do like your freedom now?**

# Part 8 – Conclusion:

## #DontMessWithTheSuper

- U.S. tax status of the Australian Superannuation is incredibly dangerous
- Treatment of the Super must be decided PRIOR to any attempt to enter the U.S. tax system
- No consensus among tax professionals and even if there were a consensus that doesn't make it right
- You should take the most defensible position that is advantageous to you
- Is YOUR Australian Superannuation a form of Social Security in Australia? Best outcome that you must strive for!
- Is YOUR Australian Superannuation something that is NOT "Social Security"? There will be U.S. tax implications! But, what?

# Tread carefully and thoughtfully!

**Practical advice:** As individuals you need to make sure that the IRS, **tax professionals** and Government of Australia get this message:

**#DontMessWithTheSuper**

**John Richardson, LL.B., J.D. – January 9, 2017**

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