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What U.S. Workers Need to Know About Australian Superannuation Plans

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The battle to attract and retain world-class talent continues to escalate with the decline of the working age population at the cusp of the Fourth Industrial Revolution.[1] Recent surveys by industry experts confirm that more workers are undertaking international assignments, from long-term, short-term, one-way transfers to locally hired personnel.[2] U.S. companies are revising their global mobility strategies and programs to provide best practices for transferring their employees overseas, including voluntary tax equalization policies that are intended to prevent their U.S. employees from incurring additional tax liabilities while abroad.[3]

For U.S. employees contemplating a foreign assignment, tax equalization policies are an important piece of the relocation package that can incentivize the employee to work overseas. After all, a U.S. employee's employment income overseas, at the very least, should not be subject to foreign taxes that are higher than taxes he would have otherwise incurred if he had opted to stay in the home country.[4] Tax equalization operates to shift the burden of paying additional foreign taxes on employment income earned overseas from the U.S. employee (i.e., the U.S. expatriate or U.S. expat) to his U.S. employer.[5]

For U.S. expats working in Australia, an important cost that should be factored into hypothetical tax equalization calculations pertains to Australian Superannuation Funds (ASF or Supers). These funds are established by legislation to provide Australian workers with an alternative source of retirement income by applying low tax rates to contributions and income accruals in the ASF while in accumulation phase; and exempting distributions from the fund from Australian income taxes when the Australian worker reaches retirement. Tax equalization formulas must include U.S. tax costs to be likely incurred by the U.S. expat arising from employer and employee contributions, accruals, and distributions from the fund, which are attributable to the U.S. expat as taxable gross income notwithstanding Australian superannuation and tax

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[1] The decline in working age population is a factor in the increase in international mobility. The increase is also due to the focus on current global value chain methodology as well as the rise of the Fourth Industrial Revolution. *See* World Economic Forum, *The Future of Jobs: Employment Skills and Workforce Strategy for the Fourth Industrial Revolution* (Jan. 2016), available at https://www.weforum.org/reports/the-future-of-jobs.

[2] *See Infographics from the 2015 Worldwide Survey of International Assignment Policies and Practices*, Mercer, LLC (2015), https://www.imercer.com/content/global-mobility-trends-infographics.aspx.

[3] *See* Thomas H. Wilson & Martin Luff, Vinson & Elkins LLP, *Practice Note: Best Practices for Transferring U.S. Employees Overseas*, Practical L. Ctr. 5-500-6179 (May 2017); Donald C. Dowling, Jr., White & Case LLP, *Secondment Agreement for Expatriates*, Practical L. Ctr. 8-523-9219 (May 2017).

[4] This concept of tax equalization also applies to U.S. persons who migrate to another country on their own dime to pursue employment with other foreign employers or self-employment.

[5] Tax equalization policies are determined by utilizing a hypothetical tax concept to forecast tax liabilities that the U.S. expat would have incurred in the home country (versus actual taxes to be incurred in the foreign country) to arrive at the amount of withholding taxes to be paid by the U.S. expat and offsets to federal and foreign taxes paid by the employer.

laws that would provide otherwise. A tax calculation that fails to take ASF contributions, income, and future distributions into account unduly exposes the U.S. expat to potential double taxation currently and years later when the U.S. expat retires and receives distributions from the ASF.

The continuing lack of authoritative guidance from the Department of Treasury or Internal Revenue Service on the U.S. tax treatment of ASFs in which U.S. persons are members gives rise to inconsistent U.S. and Australian tax results. The absence of a single definitive approach to the classification, reporting and taxation of ASFs for the U.S. tax purposes provides the U.S. expat with unclear options for tax compliance. U.S. expatriates should be cognizant of how these ASFs are structured, how they operate, and their options for achieving U.S. tax compliance with respect to these interests to fully understand that the tax costs of a foreign assignment extend beyond payroll withholding taxes.

WHAT IS AN AUSTRALIAN SUPERANNUATION PLAN?

Nationalized Private Social Security

U.S. persons working in Australia are subject to a very different national pension system than the United States. Australia's pension system is comprised of privately administered individual accounts that are mandatory for all Australian workers. This system, generally referred to as the Australian Superannuation System,[6] was introduced in 1992 as a substitute or supplement[7] to Australia's publicly administered social security program,[8] which consists of retirement, survivor, and disability benefits (Age Pension)[9] and voluntary savings that are funded from public revenues.

To date, there are numerous different types of superannuation entities, such as funds and trusts that operate under the Superannuation System. For example, the Australian Superannuation Fund (ASF), the Approved Deposit Fund (ADF), and Pooled Superannuation Trust (PST)[10] are superannuation entities that are regulated pursuant to the Superannuation Industry (Supervision) Act of 1993 (SISA) and its Regulations (SISR) (collectively, SIS Legislation)[11] that arise under the pension and corporation powers of the Australian Constitution.[12] Therefore, these funds and trusts that are regulated under such powers are eligible for tax concessions if they constitute a ''complying superannuation fund.''[13] To be one, it must have (1) either a constitutional corporate trustee[14] or its governing rules must provide that the sole or primary purpose of the fund is the provision of ''old age pensions,''[15] and (2) the trustee of the fund must file an irrevocable election with Australian Prudential Regulatory Au-

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[6] Jonathan Barry Forman & Gordon D. Mackenzie, *Optimal Rules for Defined Contribution Plans: What Can We Learn from the U.S. and Australian Pension Systems?*, 66(3) Tax Law 613, 624 (Jan. 11, 2013), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954879.

[7] *Id.*

[8] *See* U.S. Social Security Administration Program Operations Manual System (POMS), Overview of the Australian Social Security System, at GN 01743.010, available at http://policy.ssa.gov/poms.nsf/lnx/0201743010. The Australia social security program is comprised of the Age Pension and Voluntary Savings. Jonathan Barry Forman & Gordon D. Mackenzie, *Optimal Rules for Defined Contribution Plans: What Can We Learn from the U.S. and Australian Pension Systems?* 66(3) Tax Law 613, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954879.

[9] *See* U.S. Social Security Administration Program Operations Manual System (POMS), Coverage and Contributions under the Australian System, at GN 01743.015(B), available at http://policy.ssa.gov/poms.nsf/lnx/0201743010.

[10] For example, the Approved Deposit Fund (ADF) and Pooled Superannuation Trust (PST) are superannuation entities that are also regulated under SIS legislation. We note, however, that ADFs are indefinitely continuing funds that are maintained by a registrable superannuation entity (RSE), a licensee that is a constitutional corporation solely for approved purposes (i.e., receive rollovers of superannuation benefits). Under SISA s 10(1), a PST is treated as a resident unit trust (the trustee of which is a trading or financial corporation) used for investing in certain assets under SISA s 48.

[11] SIS is administered by APRA, ASIC, the Commissioner of Taxation, and the Chief Executive of Medicare. The Commissioner of Taxation was added as a regulator primarily for the administration of SIS Legislation as it related to self-managed superannuation funds (SMSF).

[12] *See generally* SISA s 3(2).

[13] *See generally* SISA s 3(2), s 19(2) to s 19(4).

[14] *See* Superannuation in Australia (CCH) at ¶2-170. A constitutional corporation is a trading or financial corporation (as defined under Par. 51(xx) of the Australian Constitution) formed within the limits of the Commonwealth. Hence, a corporate trustee of a superannuation fund is a financial corporation by virtue of its activity as a trustee of the fund that is managed by its directors and officers. It is subject to all duties, obligations, and penalties under the Corporations Act of 2001 (CA) as well as SIS Legislation. Alternatively, a superannuation trustee company is a company incorporated under the Corporations Act of 2001, whether its sole purpose is to act as trustee of a regulated superannuation fund. The company's constitution must have a clause prohibiting the company from distributing income or property to its members. *Id.* Reasons for choosing a corporate trustee include protection from business creditors and administrative ease when trustees change. *Id.*

[15] An ''old age pension'' has the same meaning as Par. 51(xxiii) of the Australian Constitution. It means a pension or annuity commencing at normal retirement age. The pension may be an allocated pension (a non-life annuity where the participant elects the amounts he or she will receive, subject to certain minimum limits) and may be payable by the fund or may be purchased from a provider using the member's benefit entitlements.

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thority (APRA) or Australian Tax Office (ATO) for the fund to be regulated under SISA.[16]

ASFs range from (1) corporate or employer-sponsored funds;[17] (2) industry funds;[18] (3) retail funds;[19] (4) public sector funds; (5) small APRA funds;[20] and (6) self-managed superannuation funds (SMSFs).[21] Notwithstanding its permutations, all ASFs share the same fundamental structure and operations as detailed below:

> A majority of superannuation funds operate under a trust structure[22] that is mandated by Australian law.[23] The sole purpose of each trust is investment superannuation assets to provide monetary benefits to an Australian worker (the ''member'') upon retirement, death, or termination of employment.[24] The trust is settled by an initial transfer of money or other property from an employer to the trustee to be held in trust for its member, followed by the execution of a trust deed that gives the trustee additional powers and duties to make sure that the fund abides by Superannuation, legislative, or state trustee laws. Lastly, the trustee must give APRA or ATO an irrevocable election for the trust to fall under SISA regulations and constitute a ''complying superannuation fund.''[25] A complying superannuation fund that is at all times a ''resident regulated superannuation fund'' during the year is classified for Australian income tax purposes as an ASF within the meaning of the Australian Income Tax Assessment Act of 1997.

Investments by the Fund

Contributions received by the ASF from employer and employees, as well as earnings accrued on such amounts from investments made while in the ASF, are taxed at low concessional rates. However, an Australian worker who is a member of the ASF cannot access its assets until either ''preservation age,'' death, or disability. At that time, the benefits accrued in the ASF may be distributed to the member on a lump-sum or periodic basis (or combination of both) without incurring additional Australian tax on such distributions. Until preservation age is reached (or such other conditions of release), investment activities by the ASF are strictly regulated by an interlocking web of SISA legislation and other regulatory regimes[26] that impose ''quite rigorous regulatory standards''[27] on its operations and investment activities. In this regard, scholars have identified a number of broad investment principles that govern how funds are invested, and specific prohibitions with respect to fund investments.[28] For example, borrowing by the ASF is strictly prohibited by SISA Legislation and can only be done under certain circumstances. This has resulted, of course, in a variety of creative investment strategies utilized by fund advisors to maximize earnings. Notwithstanding

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[16] *See* SISA s 19(2) to s 19(4).

[17] Funds established for the benefit of employees of the sponsoring employer(s) or a group of related entities.

[18] Funds established generally for employees under an industrial agreement or award.

[19] Funds that offer superannuation products to the public, including master trusts (an umbrella trust or fund that uses a single trustee and a single common trust deed to operate the superannuation arrangements for unrelated individuals and/or companies).

[20] APRA supervises a wide range of superannuation funds, including Approved Deposit funds and Pooled Superannuation Trusts, under the Superannuation Industry (Supervision) Act of 1993. However, some types of superannuation funds are exempt from APRA supervision. Public sector superannuation funds under the responsibility of relevant Federal, State or Territory Governments are exempt from prudential supervision, unless they have opted to be supervised by APRA. Self-managed superannuation funds (SMSFs), which can have no more than four members all of whom are trustees of the fund, are regulated by the Australian Taxation Office (ATO). *See* APRA Factsheet 3.

[21] Funds with fewer than five members that are regulated by the ATO.

[22] Australian Tax Office, *Income Tax: Meaning of "Australian Superannuation Fund" in Subsection 295-95 of the Income Tax Assessment Act of 1997*, TR 2008/9 at ¶99, citing views expressed in *JD Mahoney v. FCT*, 13 ATD 519 (1965); *Walstern Pty Ltd. v. FCT*, 138 FCR 1 (2003); *British Insulated & Helsby Cables v. Atherton*, [1926] AC 205. *See id.* at ¶119. See also Australian Tax Office, *Income Tax: Superannuation Contributions*, TR 2010/1 at ¶115, noting that ''as money or property is required to constitute a trust, money or other property is required to constitute a superannuation fund that is constituted as a trust consistent with the requirements of the SISA.'' *Id.*

[23] Australia views Supers as ''essentially trusts'' established to hold and invest in superannuation assets. R.L. Deutsch, M.L. Friezer, I.G. Fullerton, R.J. Hanley, T.J. Snape, The Australian Tax Handbook, Thompson ATP, Sydney, 2014, p. 1566.

[24] *See* Australian Tax Office, *Income Tax: Superannuation Contributions*, TR 2010/1 at ¶113 (Feb. 10, 2010), citing *Scott v. Commissioner of Taxation (No. 2)*, (1966) 40 ALJR 265 at 272 per Windeyer, J.; *Mahony v. Commissioner of Taxation*, 41 ALJR 232 (1967) at 232 per Kitto J; *Walstern v. Federal Commissioner of Taxation*, 9003 FCA 1428 at ¶53–¶54 (2003), 138 FCR 1 at 15–16.

[25] *See* SISA s 19(2) to s (4).

[26] The APRA; Chief Executive Medicare; Australian Securities and Investments Commission; Australian Taxation Office and the Fair Work Ombudsman are regulatory agencies that share oversight of the Superannuation Fund industry.

[27] *Finch v. Telstra Super Pty Ltd*, [2010] HCA 36 at ¶34 (Oct. 20, 2010).

[28] *See* Jonathan Barry Forman & Gordon D. Mackenzie, *Optimal Rules for Defined Contribution Plans: What Can We Learn from the U.S. and Australian Pension Systems?* 66(3) Tax Law 613, 655, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954879.

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the variety of investment strategies available to an ASF these days, it has been observed that a majority of ASF members do not exercise the choice to diversify and instead end up investing in default strategies investment by the fund.[29] As a result, a majority of the ASFs in Australia are combined in defined contribution schemes such that financial risks are borne by the fund members and not covered by the ASF.[30]

Concessional Tax Rates

While ASFs are generally trusts in Australia, general principles of Australian tax laws applicable to trusts were intentionally modified[31] to carve out a preferential tax scheme for ASFs rather than impose ordinary trust tax law provisions applicable to ordinary and public trusts.[32] This departure from the application of general Australian tax laws applicable to ordinary trusts seem warranted for ASFs because these trusts are mandated by Australian legislation and do not arise out of private contractual arrangements between employer and employee, grantor trustee and beneficiary.

All contributions and earnings accrued in the ASF are taxed at concessional rates of 15%. However, a change in the residency of the ASF's active member would cause the ASF to lose its status as a ''complying superannuation fund,'' which would in turn, trigger Australian tax consequences. This scenario is likely to occur when the Australian worker relocates back to the U.S. before retirement, in which case central management and control of the ASF also changes from Australia to the United States.[33] To avoid a premature and inadvertent loss of ASF status, the ASF is often transferred to a bigger corporate fund, retail fund, or another SMSF with a corporate trustee that is based in Australia and can exercise central management and control in Australia. Otherwise, a change of residency by the member to a location outside of Australia on a permanent basis would result in an exit of the ASF itself from the Superannuation System, resulting in the taxation of the entire balance in the fund at non-concessional tax rates for ASF monies to be disbursed to the nonresident member.

PRIVATE AUSTRALIAN SUPERANNUATION PLANS

Many private ASFs are accumulation funds, most of which bear similarities to a defined contribution fund in the United States.[34] In an accumulation fund, a member's superannuation benefits in retirement are based on the amount contributed by the employers, the amount contributed voluntarily by the member, and the amount earned by the superannuation fund investing the contributions.

Components of ASFs

Contributions to private ASFs are primarily from mandatory employer contributions referred to as the Superannuation Guarantee (SG) and voluntary employee contributions. The SG component varies, yet the minimum percentage of employer contributions to date is 9.5% of the employee's gross compensation. SG contributions are taxed to the ASF at a rate of 15% upon transfer to the ASF, plus another 15% on income accruals while in the ASF. Voluntary employee contributions to the ASF can be made on a pre-tax and after-tax basis. Payment of the voluntary pre-tax amounts, which are deductible to the Australian worker, are taxed at 15% upon transfer to the ASF and another 15% on accruals to such amounts thereafter. No further tax is imposed on the pre-tax and after-tax contributions upon distribution.

Generally, the account balance in a private ASF cannot be accessed until reaching ''preservation age,''[35] death, or disability.[36] At that time, the superannuation benefits accrued in the ASF in an accumu-

[29] George Kudrna, *Does pre-funding of retirement incomes work? The case of Australia's superannuation* (Oct. 2013) in Pre-Funded Pension Plans: Theory, Practice, and Issues, *Does Pre-funding Work?* — Abstracts by ARC Centre of Excellence in Population Ageing Research (CEPAR) and the Research Institute for Policies on Pension and Aging (RIPPA) (Project on Intergenerational Equity).

[30] *Id.*

[31] Super taxation is governed by Div. 295 of the Income Tax Assessment Act of 1997.

[32] Australia views Supers as ''essentially trusts'' established to hold and invest in superannuation assets. R.L. Deutsch, M.L. Friezer, I.G. Fullerton, R.J. Hanley, T.J. Snape, The Australian Tax Handbook, Thompson ATP, Sydney (2014), p. 1566.

[33] *See generally*, Australian Tax Office, *Income Tax: Meaning of ''Australian Superannuation Fund'' in Subsection 295-95 of the Income Tax Assessment Act of 1997*, TR 2008/9 (Dec. 2, 2008). The alternative test is that at least 50% of the sum of amounts that would be payable to or in respect of active members if they voluntarily ceased to be members is attributable to superannuation interests held by active members who are Australian residents. *See Income Tax Assessment Act 1997* s 295-95(2)(c)(ii).

[34] *See* Australian Securities and Investment Commission (ASIC), *Types of Superfunds*, available at https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/types-of-super-funds#difference. These are also known as defined contribution funds. Most corporate or public-sector funds are defined benefit funds, which are now closed to new members. The value of the retirement benefit is defined by fund rules. Compared with defined contribution funds, the employer or the fund generally takes the risk in defined benefit funds.

[35] The preservation age is the earliest age that retirement benefits can be paid from a Super and still get concessional tax treatment. Jonathan Barry Forman & Gordon D. Mackenzie, *Optimal*

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lation account are transferred over to the pension account, which can be accessed by the Australian worker as a pension distribution. The distribution is payable in lump sum, periodically or both.[37] Regardless of manner of distribution, the ASF's accrued benefits in a pension account are generally distributed tax-free.

U.S. Tax Treatment

The main issue with respect to private ASFs with members who are U.S. persons is whether the contributions, accruals, and distributions from the ASF constitute gross income to the U.S. person; and if so, whether such gross income should be reported by that U.S. person on his U.S. tax return and taxed on a current basis and how. This is a stark departure from Australian Superannuation and tax laws, which generally do not treat contributions, accruals, and distributions from an ASF as assessable income to the Australian worker that would subject such worker to personal taxation in Australia. Rather, the ASF itself is taxed on amounts contributed and accrued on the fund.[38] Currently, it would appear that a U.S. person who is also an Australian worker would have to classify amounts contributed, accrued, and distributed from his ASF differently for U.S. tax purposes and Australian tax purposes. For U.S. tax purposes, such amounts constitute part of his worldwide gross income, subject to U.S. income taxes on a current basis. For Australian tax purposes, such amounts constitute non-assessable income that is exempt from Australian income taxes. This divergent United States and Australian tax treatment of amounts contributed, accrued, and distributed from an ASF creates pitfalls and challenges for a U.S. person working in Australia. The reason for this divergence is discussed below.

IRS Private Letter Rulings: ASFs as Trusts

Generally, the foreign classification of an entity does not control its classification under U.S. law.[39] Thus, the treatment of ASFs as trusts in Australia is not determinative of its U.S. tax classification. Indeed, to date neither the Treasury Department nor IRS has issued any authoritative guidance on how ASFs are classified for U.S. tax purposes. Nonetheless, the IRS has published three private letter rulings (PLRs)[40] that held that a foreign trust providing superannuation benefits to its members constituted a trust for U.S. federal income tax purposes.[41] In determining the U.S. classification of the foreign trust as a trust under U.S. tax laws, the IRS was asked to assume that the foreign trusts were employee trusts per se. Therefore (based solely on our conjecture and without affirmation or confirmation from IRS), the conclusion reached in the PLRs was not dependent on an analysis of whether the underlying arrangements were in fact employee trusts. The fact that the IRS assumed that the foreign trusts were employee trusts instead of determining whether such trusts are employee trusts has influenced the de facto classification of ASFs as employee trusts in the United States without further diligent inquiry on the basis for such treatment.

Section 402(b) Employee Trusts

Under existing U.S. domestic tax laws, a U.S. person who participates in a funded, foreign pension plan may be subject to taxation under §402(b). Some tax practitioners have taken the position that ASFs are funded and secured foreign pension plans and should be subject to §402(b) treatment.

Under §402(b), a U.S. person participating in a non-exempt foreign employee trust must include in income an amount calculated under §402(b)(4).[42] This provision taxes the U.S. person on his ''entire

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Rules for Defined Contribution Plans: What Can We Learn from the U.S. and Australian Pension Systems? 66(3) Tax Law 613, 620, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1954879.

[36] *Id.* at 640.

[37] *Id.* at 641.

[38] Funds are ''in effect'' treated as quasi-trustees of the income accruing to individuals, which are ultimately paid out to them as tax-exempt benefits. Tax is collected from the funds on behalf of the ultimate beneficiaries. *See* Asprey 1977 Report ¶15.69–¶15.80 at p. 246.

[39] Reg. §301.7701-1(a)(1). All section references herein are to the Internal Revenue Code of 1986, as amended (I.R.C.), and the regulations thereunder, unless otherwise specified. Reg. §301.7701-1(a)(1) specifically provides that ''[t]he Internal Revenue Code prescribes the classification of various organizations for federal tax purposes. Whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the organization is recognized as an entity under local law.''

[40] PLR 201538008, PLR 201538007, and PLR 201538006. In all three PLRs, the foreign trust was governed by foreign legislation and regulated by several government entities. The trust, which had the sole purpose of providing superannuation benefits to its members and their beneficiaries, was managed by trustees. All funds were derived from employer and employee contributions and investment income. The trustees had a duty to manage funds in a responsible order to protect and preserve superannuation and provide an annual statement to beneficiaries that included information about the foreign trust as required by law. The trust was subject to a foreign audit by an approved auditor and members of the trust could not unilaterally assign or transfer their benefits in the trust to another person.

[41] *Id.* Reg. §301.7701-4(a).

[42] We note that the ASF or SMSF, as other foreign pension plans, would be subject to §402(b)(4) because one of the reasons it would fail to be classified as an exempt plan under §501(a) is because of its failure to satisfy the coverage testing under §401(a)(26) or §410(b) with respect to highly compensated employees (the nondiscrimination rules). The foreign plan would fail because the coverage testing requires the exclusion of coverage

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vested accrued benefit'' in a non-exempt foreign employees trust at the close of the taxable year in which the foreign employees trust was not exempt under §501(a). Under an alternative provision for foreign employees trusts, §402(b)(1), a U.S. person would be taxed on his employer's contributions (and not employee contributions) to the foreign employees trust to the extent that the employee's interest in the foreign nonexempt trust is ''substantially vested.''[43] If, however, it is determined that the employee contributions to the trust are ''not incidental''[44] when compared to the employer contributions, then Reg. §1.402(b)-1(b)(6) would treat the portion of the foreign employees trust that constitutes the employee contributions as if such portion were a grantor trust. This would mean that all employee contributions made by the employee himself would be considered individual income and non-compensatory.[45] The U.S. person would be subject to current tax on the portion of the foreign employee trust that is reclassified as a grantor trust to the extent of such employee contributions pursuant to Reg. §1.402(b)-1(b)(6). Tax practitioners have been perplexed on how to apply Reg. §1.402(b)-1(b)(6) to ASFs without any further guidance on what would constitute an employee's contribution and an employer's contribution for purposes of this regulation, and, more importantly, what would constitute a ''not incidental'' employee contribution.[46]

If any of the §402(b) provisions discussed are applied to the ASF, a U.S. person would be required to report and pay taxes on either (1) his entire vested accrued benefit in the ASF under §402(b)(4); (2) all employer contributions made on his behalf to the extent such U.S. person's interests in the ASF are ''substantially vested'' under §402(b)(2); or (3) all employee contributions made to the ASF as if the ASF were an employee grantor trust under Reg. §1.402(b)-1(b)(6).[47]

Grantor Trust Under §679

As previously stated, treatment of the ASF as a grantor trust in cases where the employee contributions are ''not incidental'' to employer contributions under Reg. §1.402-1(b)(6) results in a partial grantor trust treatment of the ASF with respect to the employee contributions. However, other tax practitioners have treated the entire ASF as a foreign grantor trust based on the grantor trust rules in §671–§679, resulting in a full attribution of all contributions and earnings accrued in the ASF to the U.S. person member. Consequently, foreign-sourced income from the ASF is fully included in the U.S. person's gross income for U.S. tax purposes. A corollary result of foreign grantor trust treatment is the attribution of stock ownership of foreign corporations directly held by the ASF to the U.S. person, which would trigger passive foreign investment company (PFIC) reporting obliga-

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for nonresident aliens who participate in the plan along with U.S. expatriates.

[43] *See* Reg. §1.402(b)-1(a), Reg. §1.402(b)-1(b). The Advisory Committee on Tax Exempt and Government Entities (ACT) released a report dated June 10, 2009, on international pension issues that specifically recommended that the IRS allow nonresident aliens who are actually participating in a foreign plan to be taken into account to determine whether the plan meets §410(b) coverage rules solely for purposes of applying §402(b). Allowing this change would cause a foreign pension plan to fall under §402(b)(1) rules, which would tax the U.S. person on the employer's contributions to the foreign exempt trust during the employer's applicable taxable year for which the trust is not exempt, to the extent the employee's interest in the trust is vested. *See also* ACT, *International Pension Issues in a Global Economy: A Survey and Assessment of IRS's Role In Breaking Down the Barriers*, pp. 47–49 (June 10, 2009).

[44] Under the regulations, an employee's total contributions are not incidental when such contributions exceed the employer's total contributions made on behalf of the employee as of any date. *See* Reg. §1.402(b)-1(b)(6), Reg. §1.402(b)-1(b)(7) (examples).

[45] *See* Veena K. Murthy, *Selected Cross-Border Equity and Deferred Compensation Issues With Funded Foreign Plans*, 42 Comp. Plan. J. 67 (Apr. 4, 2014).

[46] *Id.* We have previously noted that aside from the difficulty in applying the above regulation to the Super due to the dearth in guidance on what constitutes incidental employee contributions, there is also potential difficulty in implementation. The regulation implies that one Super might be treated concurrently as (1) partially a §402(b) non-exempt employees' trust; and (2) partially a grantor trust according to what is considered an incidental or non-incidental employee contribution. The employer portion and the incidental employee portion would qualify as a §402(b) employee's trust, with income inclusion to be governed by §72 and §83. The non-incidental employee contributions would lead to immediate income recognition with possible nightmarish PFIC tax and reporting for the underlying investments. As a practical matter, tracing specific contributions to investments that constitute PFICs would be so difficult as to render such requirement nearly impossible. *See* Roy Berg & Marsha Dungog, *U.S. Taxation of Australian Superannuation Funds*, 84(2) Tax Notes Int'l 177 (Oct. 10, 2016).

[47] We do not believe that either of these §402(b) provisions should be applied to a U.S. person's interests in an Australian superannuation fund. Tax practitioners who have applied §402(b) to tax contributions and accruals to an ASF as income constructively received by the U.S. person who is a member of such ASF under the authority of Rev. Rul. 57-528, 1957-258 C.B. 263, and Rev. Rul. 57-37, 1957-1 C.B. 18 (collectively, the Revenue Rulings), fail to differentiate between the employer contributions made in the Revenue Rulings (which were made to unfunded and unsecured deferred compensation arrangements) and employer contributions made to an ASF (which are funded and secured). Further, the employer contributions in the Revenue Rulings were voluntary, as opposed to ASF contributions, which are mandatory to the Australian employer. For further discussion of these technical tax distinctions, *See* Roy Berg & Marsha Dungog, *U.S. Taxation of Australian Superannuation Funds*, 84(2) Tax Notes Int'l 177 (Oct. 10, 2016).

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tions and potential PFIC taxes.[48] Indeed, extending foreign grantor trust treatment to the entire ASF effectively creates an ongoing tax burden to the U.S. expat in the form of likely double taxation of contributions and income accruals from corporate distributions received by the ASF from PFICs. It also causes the U.S. person to incur more professional fees to fully comply with these complex U.S. tax reporting obligations.

Article 18 of the Australia-U.S. Tax Treaty

If either §402(b) or §679 were to apply to both the SG and employee components of the ASF, which we do not believe to be the correct conclusion, it would lead to double taxation of contributions and income accrued in the ASF, as well as distributions.[49] In general, tax practitioners would look to the Australia-U.S. Tax Treaty to resolve any incidence of double taxation.

However, Article 18 of the current Australia-U.S. Tax Treaty[50] fails to reconcile the occurrence of double taxation on contributions, accruals, and distributions from an ASF to its U.S. expat member. The pension-relevant provisions of the Tax Treaty under Article 18 have not been significantly updated since it was ratified in 1983, notwithstanding the Protocol, which was signed in 2001. Consequently, it does not sufficiently address the taxation of contributions, accrued income, and distributions from an ASF.

In its current version, Article 18(1) of the Tax Treaty provides that pensions and other similar remuneration paid to a resident of Australia in consideration for past employment shall be taxable only in Australia. The term ''pensions and other similar remuneration'' under Article 18(4) covers periodic payments made by reason of retirement or death, in consideration for services rendered in connection with past employment.

Indeed, one could take the position that amounts disbursed from the ASF to a U.S. expat would constitute distributions from a foreign pension subject to tax in Australia and not the United States. This position must be considered in light of Article 1(3), under which the United States reserves the right to tax its citizens on a worldwide basis as if the Tax Treaty were not in force (the Saving Clause).

The result could be that a U.S. person who is a resident of Australia and member and beneficiary of an ASF is subject to tax in Australia and the United States on income from wages constructively received from: (1) SG contributions and concessional employee contributions to the ASF, and (2) income accrued to the ASF.[51]

If the Tax Treaty were revised to incorporate Article 18 of the 2006 and 2016 U.S. Model Income Tax Conventions (U.S. Model Treaties), then none of the SF or employee contributions to the ASF or income accruals thereafter would be taxable to the U.S. Person.

Articles 18(2) and 18(4) of the 2006 Model Treaty and Article 18(3) of the 2016 Model Treaty[52] apply to situations where the individual is a U.S. citizen and resident of the host country. It provides that contributions attributable to employment paid by or on behalf of the individual during the employment period to a pension fund are deductible or excludible in computing the individual's U.S. tax; further, any accrued pension benefits or employer contributions attributable to employment made by the U.S. person's employer are not treated as taxable to the individual in the U.S.[53] Article 18(2) and 18(4) of the 2006 Model Treaty and Article 18(3) of the 2016 Model Treaty are excepted from the Saving Clause of both U.S. Model Treaties.

Foreign Social Security

Absent authoritative IRS guidance to date on the U.S. tax classification of ASFs, it would be incomplete to reference §402(b) and §671–§679 as the only domestic tax provisions in the Code that may be applied to ASF. We have previously noted that the Australian Superannuation System bears striking similarities to the U.S. social security and likely functions as its foreign equivalent.[54] Indeed, recent legislative reforms to Australian Superannuation laws effective July 1, 2017 include a formal legislated objective provision for the superannuation regime, which is to provide retirement income to Australians that would substitute or supplement the Age Pension for Austra-

[48] *See, e.g.,* Reg. §1.402(b)-1(b)(6).

[49] While double taxation on contributions and income accruals to the ASF would occur in the same taxable year, the double taxation on ASF distributions would occur because amounts distributed by the ASF have already been previously taxed while accumulating in the ASF; yet, those same amounts would again be taxed by the United States upon distribution.

[50] Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Australia-U.S. (Aug. 6, 1982), 35 U.S.T. 1999 (hereinafter the Tax Treaty), as amended by Protocol signed on September 27, 2001.

[51] Mandatory distributions from the Super that commence at the Pension Phase are only subject to tax in the United States and generally not in Australia under Article 18 of the Tax Treaty.

[52] U.S. Dept. of the Treasury, 2016 U.S. Model Income Tax Convention (hereinafter the 2016 U.S. Model Tax Treaty), available at https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf.

[53] *See* Staff of the Joint Committee on Taxation, Comparison of the United States Model Income Tax Convention of September 20, 1996, With the United States Model Income Tax Convention of November 15, 2006, pp. 23–24 (2007).

[54] *See* Roy Berg & Marsha Dungog, *U.S. Taxation of Australian Superannuation Funds*, 84(2) Tax Notes Int'l 177 (Oct. 10, 2016).

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lians.[55] This supports U.S. classification of ASFs as neither non-exempt foreign employee trusts nor grantor trusts, as acknowledged in the Australia-U.S. Totalization Agreement.

The Superannuation Guarantee (SG) portion of the ASF, which comprises a part of the mandatory employer contributions to ASFs to supplement benefits payable under the Social Security program,[56] falls squarely within this category of social security. The Superannuation Guarantee is a privatized mandatory savings scheme that pre-specifies a minimum amount of contributions from employers on behalf of their employees.[57] All contributions are portable, fully funded and fully preserved (i.e., they must be kept together with investment earnings in the ASF until the statutory access age is reached) (Funded and Secured).[58] Once received by the ASF, contributions are placed entirely in the private sector[59] in individual accounts and invested on behalf of the employee individuals.[60] Fund investment earnings are added to superannuation assets that may be withdrawn upon reaching the statutory eligibility age,[61] and also used to compute eligibility for the Age Pension,[62] which is intended to operate as a safety net for those who cannot provide for themselves in retirement. At the time of its implementation, the belief was that the Superannuation scheme would eventually build up and reduce the Age Pension to a simple welfare measure by the Commonwealth to pay a destitute payment or supplement only.[63] Indeed, it was anticipated that, by 2005, payments from Australia's social security network would decrease substantially as payments from the Superannuation funds increased.[64]

Australia's intent to replace the Age Pension with the Superannuation System is reflected in the Social Security (International Agreements) Act of 1999 (SSIA),[65] which was enacted in March 2000 shortly before the implementation of the Superannuation Scheme in the same year. The SSIA's scope explicitly references Australia's existing social security laws and the Australian SGAA as the two primary regimes in Australia that would be subject to an international agreement on social security with another country (a "scheduled international social security agreement" or "totalization agreement")[66] that would override Australia's domestic Social Security law.[67]

Closer scrutiny of the SG Contribution amounts payable by an Australian employer under the SGAA Scheme shows substantial similarities between the U.S. Social Security taxes FICA, SECA, and the Superannuation Guarantee.[68] The similar nature of these taxes has been acknowledged and placed within the

[55] In November of 2016, the Australian Parliament passed legislation to implement superannuation reforms to make the widely popular superannuation system more sustainable for its aging population by increasing flexibility and incentives for savings. See Superannuation (Objective) Bill 2016, which sets out a clear objective for Superannuation: to provide income in retirement to substitute or supplement the Age Pension. See http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/Superannuation-Reforms. The provisions of the Superannuation Reform package pertaining to a formal legislated objective for the superannuation system was split from the other elements of the reform package that was passed by the Senate in November 2016. Rather, the legislated objective provision was referred by the Senate to the Senate Economics Legislation Committee (SECL) for inquiry and report by February 14, 2017. The SECL report, issued February 2017 recommended passage of the Superannuation Bill 2016 provision on legislated objective and can be accessed at the following link: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/SuperObjectiveBill2016/Report.

[56] *See* U.S. Social Security Administration Program Operations Manual System (POMS), Overview of the Australian Social Security System, at GN 01743.010, available at http://policy.ssa.gov/poms.nsf/lnx/0201743010.

[57] George Kudrna, *Does pre-funding of retirement incomes work? The case of Australian's superannuation* (Oct. 2013) in *Pre-Funded Pension Plans: Theory, Practice, and Issues Does Pre-funding Work* — Abstracts by ARC Centre of Excellence in Population Ageing Research (CEPAR) and the Research Institute for Policies on Pension and Aging (RIPPA) (Project on Intergenerational Equity).

[58] *Id.*

[59] *See* Jerry W. Markham, *Privatizing Social Security*, San Diego L. Rev. 747, 813 (2001).

[60] George Kudrna, *Does pre-funding of retirement incomes work? The case of Australian's superannuation* (Oct. 2013) in *Pre-Funded Pension Plans: Theory, Practice, and Issues Does Pre-Funding Work* — Abstracts by ARC Centre of Excellence in Population Ageing Research (CEPAR) and the Research Institute for Policies on Pension and Aging (RIPPA) (Project on Intergenerational Equity).

[61] *Id.*

[62] Professor Markham has observed that unlike Social Security, Australian Age Pension is viewed as a safety net for those unable to provide for themselves in retirement. Income to the recipient of an Age Pension or assets (excluding the pensioner's home and capital value of superannuation funds) in excess of specified levels will result in the reduction or elimination of benefits. *See* Jerry W. Markham, Privatizing Social Security, 38 San Diego L. Rev. 747, 814 (2001) (citing Centrelink, *Age Pensions: All You Need to Know 4* (May 2000)).

[63] *See id.* at 814–819.

[64] *Id.*

[65] *See* Office of Parliamentary Counsel (Canberra), Social Security (International Agreements) Act of 1999, at Part 1(4) (compiled Jan. 1, 2016). SSIA was enacted in March 2000 to form part of Australia's social security law.

[66] *See id.* at Part 2(5) and 2(6).

[67] See SSIA Part 2.6(1), which states that "[t]he provision of a scheduled international social security agreement have effect despite anything in social security law." *Id.*

[68] For a detailed analysis of the similarities between the U.S. FICA and SECA payroll taxes with the Australian Superannuation Guarantee, see Roy Berg & Marsha Dungog, *U.S. Taxation of Australian Superannuation Funds*, 84(2) Tax Notes Int'l 177 (Oct. 10, 2016).

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scope of coverage of the Australia-U.S. SSTA. Indeed, FICA and SECA explicitly do not apply during a period when employee wages are subject to the social security system of a foreign country pursuant to a totalization agreement between the United States and such other foreign country.[69] Here, FICA and SECA do not apply when a U.S. person is subject to Australia's Superannuation Guarantee Scheme. This in effect means that the Superannuation Guarantee is, in fact, equivalent to the U.S. social security taxes FICA and SECA.

If the SG portion of the mandated employer contributions to the ASF were to be treated as foreign social security taxes, then such contributions would be excluded from the U.S. person's gross income and therefore exempt from U.S. taxation under Article 18(2) of the Tax Treaty. It would also be logical to conclude that income accretions in the ASF and distributions therefrom should likewise be exempt from taxation by the U.S. because the United States has ceded its ability to tax social security benefit payments under Article 18(2) of the Tax Treaty. It is important to note that the Saving Clause does not apply to social security (as defined in the Tax Treaty) received by a U.S. citizen resident in Australia.[70]

PUBLIC SECTOR SUPERANNUATION FUNDS

Similar to private ASFs, public-sector Superannuation funds are publicly administered, fully-funded schemes for government employees. U.S. persons employed as federal or state workers of the Australian government who have public-sector superannuation funds also face the dilemma of determining whether such funds constitute ''government remuneration,'' which is exempt from U.S. taxes under Article 19 of the Australia-U.S. Tax Treaty. The exemption however is contingent on whether the U.S. saving clause applies, as discussed below.

What Are Public Sector Funds

Australian workers that are employed at the federal government or the state government level are members of government-administered public superannuation schemes to benefit them. Public sector employees work in local government, the commonwealth, state public services, public healthcare, emergency services, and the defense forces. Some public sector funds are defined benefit funds that may be taxed or untaxed.[71]

Federal employees participate in the Commonwealth Superannuation Scheme (ComSuper), which is a public pension funded by the Australian government for its employees. In 1990, the ComSuper was closed to new members and replaced with the Public Sector Superannuation Scheme (PSS). The PSS was established exclusively for employees of the Australian government and other participating employers. Membership in the PSS closed to new members on July 1, 2005, as is the case with other public sector superannuation funds.[72] The PSS, like most corporate or public sector superannuation funds, is a defined benefit plan.[73] This means that, unlike defined contribution funds, the value of the retirement benefits due to the Australian worker participating in the PSS is determined by the fund itself. Therefore, the risk of funding the retirement benefit falls on the government employer or the fund exclusively. The PSS is also a complying superannuation fund in Australia and therefore subject to concessional tax rates on contribution, accrual, and distribution.

Australian workers employed by a state government participate in a number of state government-based superannuation schemes. For example, the State Superannuation Scheme (State Plus) is a fund established for the benefit of employees of the Government of the State of New South Wales, while the Emergency Services and State Super (ESSS) is a superannuation scheme administered by the State of Victoria. Unlike State Plus, ESSS has both defined benefit and accumulation fund (i.e., defined contribution) components. For purposes of this article, our discussion is limited to the PSS fund.

Components of the PSS Fund

A Member's PSS benefit has three components: (1) a Member component; (2) a Productivity component;

[69] *See* I.R.C. §3111(c) (referencing §233 of the U.S. Social Security Act). Self-employed individuals are also granted an exemption from taxes under SECA under §1401(c). *See also* Rev. Proc. 80-56, 1980-2 C.B. 851, *as amplified by* Rev. Proc. 84-54, 1984-2 C.B. 489.

[70] *See* Art. 1(4)(a) of the Tax Treaty.

[71] *See* http://superguide.com.au/superannuation-toics/public-sector funds. All industry, retail and corporate funds are taxed funds. Untaxed funds are where a benefit has not been subject to contributions or earnings tax because the government does not make an actual cash contribution during the working life of the employee. The fund benefit from an untaxed fund based on a formula and paid from consolidated revenue at retirement.

[72] The Public-Sector Superannuation Accumulation Plan (PSSAP) and the PSSAP Trust Deed replaced the PSS on July 1. Government employees commencing work after July 1, 2005, automatically are enrolled in the PSSAP. *See* www.pssap.gov.au.

[73] *See* Australian Securities and Investment Commission (ASIC), *Types of Superfunds*, available at https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/types-of-super-funds#difference.

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and (3) an Employer-financed component. These are discussed below.

Member Component

The Member component is made up of voluntary member contributions from after-tax income and fund earnings. Member contributions are between 2% and 10% of their biweekly (once every two weeks) salary and not generally subject to contributions tax of 15% when deposited into the fund (the Employee Non-Concessional Contributions). Members cannot technically elect to make salary deferrals into PSS, although they are able to elect to make salary deferrals into an accumulation fund that is adjacent to the PSS.

Productivity Component

The Productivity component is made up of employer biweekly compulsory contributions and fund earnings less tax. Employer productivity contributions are taxed 15% upon contribution to the fund (concessional contributions). Employer concessional contributions are mandatory productivity contributions paid by the government employer which are equivalent to 9.5% of the employee's salary.[74] These employer concessional contributions constitute assessable income to the Fund itself and are subject to a 15% tax upon contribution (contributions tax) in Australia, and another 15% tax on earnings generated by the Fund on an annual basis (accumulation tax). These employer concessional contributions, which are made at least at the rate required under the SG of 9.5%, effectively comply with the Superannuation Guarantee or SG contributions required to be paid by private employers to a private ASF.[75]

Employer-Financed Component

Employer-financed components are additional amounts financed by the government that are calculated when the member claims their retirement benefit.[76] These amounts are not taxed.

Australian Taxation of Earnings and Distributions

Investment earnings and undistributed benefits in the Fund are taxed at concessional rates of 15% to the fund.[77] The defined part of a contributing member's superannuation benefit is unaffected by fund earnings and investment performance. However, investment performance can impact the way in which the three components of the PSS work and how the superannuation defined benefits may be taxed to the member upon withdrawal. The principal benefit to contributing members is defined by their final average salary and accrued benefit multiple (Superannuation defined benefit). The Superannuation defined benefit can be taken by a member upon reaching retirement age as either a CPI-indexed pension or a lump-sum amount or a combination of both. The Superannuation defined benefit may be taxable to a member upon distribution, contingent on age, type of benefit, and whether benefits are sourced from taxed sources (earnings and Employee Non-Concessional Contributions) or untaxed sources.

Preserved and Associate Amounts

Members who leave employment with the Australian Government or participating employers preserve all or part of their benefits with the PSS but can no longer contribute (Preserved Member). Members whose interest in a PSS are split by agreement or court order receive a new or separate superannuation interest called an Associate Interest. Splitting would typically occurs under Family Law provisions and is given effect by the trustee of the fund following a court order. The accumulation component of both the Preserved and Associate Member's interest can be affected by fund earnings based on their decision to invest in a default fund or a cash investment option, which is made up of cash, fixed interest and equities. Contributing members have their accumulation components invested in the default fund alone.

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[74] *See* https://pss.gov.au/your-scheme/how-pss-works/components/.

[75] *See* https://pss.gov.au/your-scheme/grow-your-super/employer-contributions/. Such amounts effectively comply with the "Superannuation Guarantee" or SG where superannuation contributions made are at least at the rate required under the SG. For example, the is "productively" the right word? productively contributions paid at 3% of the employees' salary by a government employer in respect of a member of the PSS is itself a lesser rate than the SF, however, the SF rate is satisfied by taking into account the total PSS contributions (i.e., including the notional contributions which are fixed at 8% of the employee's super salary). *See* email from John Arizzoli, ATO Complex Technical Unit-Technical Leadership and Advice, to Marsha Dungog, Director U.S. Tax Law, Moodys Gartner Tax Law LLP, on Superannuation (May 19, 2017) (on file with author).

[76] The website of the Australian Government's Commonwealth Superannuation Corporation provides that the employer-financed component of PSS benefits includes amounts "paid by your employer and determined when you leave PSS and claim a benefit; its value is the remaining balance when your member and productivity components are deducted from your total lump sum benefit (keep in mind, your final PSS benefit is calculated using your final average salary and accrued benefit multiple)." *See* https://pss.gov.au/your-scheme/how-pss-works/components/.

[77] Ultimately, the effective rate of tax incurred by the fund is less than 15% as funds receive a capital gains tax discount and franking credits (a type of tax credit that allows an entity to pass through taxes that have already been paid on corporate profits).

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United States Taxation of Public Sector Funds

Treatment of Employer Contributions Under Article 19 of the Australia-U.S. Tax Treaty

Unlike private ASFs, which do not have any definitive treatment under the Australia-U.S. Tax Treaty, contributions, accruals, and distributions from Australian public sector superannuation funds to U.S. persons fall under the category of "government remuneration," which is exempt from U.S. taxation under Article 19 of the Australia-U.S. Tax Treaty (Governmental Remuneration Exemption). Article 19(1) explicitly provides:

> *Wages, salaries, and similar remuneration, including pensions, paid from funds of one of the Contracting States, of a state or other political subdivision thereof or of any agency or authority of any of the foregoing for labor or personal services performed as an employee of any of the above in the discharge of governmental functions to a citizen of that State shall be exempt from tax by the other Contracting State.*[78]

Saving Clause Under Article 2

The above exemption from U.S. taxation of amounts contributed, accrued, and distributed from an Australian public superannuation fund (because it is technically a government Pension under Article 19(1)) is not absolute. Article 2(3) of the Australia-U.S. Tax Treaty carves out an exception from the Governmental Remuneration Exemption that provides:

> *Notwithstanding any provision of this Convention, except paragraph 4 of this article, a Contracting State may tax its residents (as determined under Article 4 (Residence)) . . . and by reason of citizenship may tax its citizens, as if this Convention had not entered into force. . . .*

Article 2(3), known as the Saving Clause, imposes U.S. taxing jurisdiction on remuneration and similar pensions earned by U.S. citizens who performed services for the Australian government. The scope of the Saving Clause is however also further limited by Article 2(4)(b), which excludes from U.S. tax certain government remuneration received by individuals who are citizens of the employing government. This subsection squarely addresses the government pension received by a U.S. person for work performed for the Australian Government as an Australian citizen and resident, before acquiring U.S. residency. Article 2(4)(b) explicitly states:

> *(4) The provisions of paragraph (3) shall not affect:*
>
> *(a) the benefits conferred by a Contracting Sate under . . . . paragraph (2) or (6) of Article 18 (Pensions, Annuities, Alimony and Child Support); or*
>
> *(b) the benefits Conferred by a Contracting State under Article 19 (Governmental Remuneration) . . . upon individuals who are neither citizens of, nor have immigrant status in, that State (in the case of benefits conferred by the United States), or who are not ordinarily resident in that State (in the case of benefits conferred by Australia).*

Treasury Technical Explanation

The Treasury Technical Explanation to the Australia-U.S. Tax Treaty confirms the interpretation that remuneration and related pension earned by a U.S. person as an Australian citizen and resident working for the Australian government, and prior to establishing U.S. residency, would not be subject to tax by the United States. Indeed, the Treasury Explanation of Article 19 elaborated that remuneration, including pensions, paid by the Employing State (or a political subdivision, local authority, or agency) to a citizen of that State for the performance of governmental functions is exempt from tax by the other Contracting State. However, remuneration that is paid to an individual that is a resident, but not a citizen of the Employing State, whether or not it may be taxed by the other Contracting States, is determined under other provisions of the Treaty (Article 14, Article 15, Article 17 or Article 18) as applicable.

Hence, government remuneration paid by the Australian government to a U.S. person, who is also a citizen of Australia, and more importantly, was a citizen of Australia (and not the United States) while employed by the Australian government, is exempt from U.S. tax under Article 2(4)(b).[79] The extension of this rule to government pensions paid for past services rendered to the Australian government is supported by

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[78] *See id.*

[79] We note that the tax outcome to U.S. persons who previously worked for the Australian government would be substantially different if they were citizens of the United States at the time they worked for the Australian government. Indeed, the Treasury Technical Explanation provides that:

> *If such remuneration is paid by one of the States to an individual who is a resident of the other State (or by Australia to a citizen of the United States), it may be taxed by that other State (or by the United States in the case of U.S. citizens) in accordance with paragraph 3 of Article 1 (Personal Scope) (referencing the Saving Clause).*

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the U.S. Joint Committee on Taxation's explanation of Article 19 which states:

> *Under the proposed treaty, compensation paid by one country, its political subdivisions or their agencies or authorities, to one of its citizens for labor or services rendered in discharge of governmental functions is taxable only by the paying country. Thus, for example, Australia would not tax the compensation of a U.S. citizen who is in Australia to perform services for the U.S. government in the discharge of governmental functions. This rule also applies to pensions paid in respect of past services. This provision is generally excluded from the Saving Clause for persons who are not citizens of or immigrants in the source country.*[80]

Based on the above analysis, it is more likely that Article 19 of the Australia-U.S. Tax Treaty would exclude Employee Non-Concessional Contributions and earnings accrued on such amounts from U.S. taxation provided that such amounts are paid by the Australian government to the U.S. person as pension for past services rendered prior to establishing U.S. residency.

Treatment of Employee Non-Concessional Contributions

At this point, we have established that (1) public sector superannuation funds constitute governmental remuneration under Article 19 of the Australia-U.S. Tax Treaty; (2) contributions, accruals, and distributions from such funds to Australians in the United States who worked for the Australian Government, are exempt from U.S. taxes under the Government Remuneration Exemption under Article 19(1); and (3) the Governmental Remuneration Exemption extends to contributions, accruals, and distributions from such funds to U.S. citizens who worked for the Australian Government prior to attaining U.S. citizenship under Article 2(4)(b). What remains to be addressed is how Employee Non-Concessional Contributions, accruals, and distributions from the public-sector fund are taxed for U.S. purposes when the U.S. person was already a U.S. citizen at the time they worked for the Australian Government. Clearly, such amounts are not exempt from U.S. tax because this situation would fall within the scope of the Saving Clause of the Australia-U.S. Tax Treaty.

Under such circumstances, we would recommend bifurcating the U.S. tax treatment of employer contributions from Employee Non-Concessional Contributions under Article 18 of the Australia-U.S. Tax Treaty.

Employer contributions, which are essentially government contributions equivalent to the SG, would be exempt from U.S. tax as social security taxes under Article 18(2) of the Tax Treaty. As a corollary, accruals and distributions from the public sector fund would constitute social security benefit payments to the extent such amounts are attributable to the SG portion of the fund.

Employee Non-Concessional Contributions to the public sector fund made by the U.S. person would be treated substantially similar to investments made by U.S. citizens into an after-tax IRA under §408(a). Specifically, both the contribution and investment earnings accrued from such after-tax contributions constitute gross income to the U.S. person subject to U.S. income tax.

Treatment of Distributions

Similarly, retirement benefit distributions from public sector funds operated by the federal and state governments of Australia would be excluded from U.S. taxation under Article 19 of the Australia-U.S. Tax Treaty. This treatment of public pension distributions departs from Article 18 provisions which would subject such amounts to U.S. taxation if the U.S. person was already a U.S. citizen working for the Australian government at the time the public-sector superannuation account for such U.S. person was established. If such were the case, U.S. taxation of their Australian pension distributions would be subject to a foreign tax credit offset under Articles 22 and 24 of the Australia-U.S. Tax Treaty to prevent retirement benefits from being double taxed.

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[80] *See* Explanation by the Joint Committee on Taxation (1983) on Income and Capital Tax Treaty, 1986-2 C.B. 220 (IRS FIA) (as signed May 23, 1983).

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