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SPECIAL REPORT

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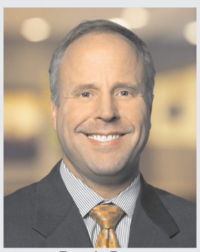

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In this article, the authors identify the U.S. federal income tax reporting and compliance uncertainties that U.S. citizens in Australia face regarding contributions and income accretions in Australian superannuation funds. Noting that those uncertainties arise from tax law incongruities not addressed in the Australia-U.S. treaty or the Australia-U.S. Social Security totalization agreement, the authors recommend that Treasury and the IRS issue clarifying guidance.

I. Summary

The U.S. tax consequences to U.S. participants in foreign social security programs generally mirror the consequences to participants in U.S. Social Security programs: Contributions and accretions are not taxed, but distributions are. When inconsistencies arise, income tax conventions and social security totalization agreements (SSTAs) generally resolve them. However, under U.S. law, when the foreign social security program is fundamentally different from the U.S. program (as is the case for Australia), the older income tax conventions and SSTAs to do not resolve the adverse U.S. tax consequences for affected individuals. This report analyzes those differences in the context of Australia's social security program and suggests ways to resolve them.

Over the past several years, the United States has considered and rejected numerous proposals to modify its Social Security programs.[1] Current Social Security programs bear the following hallmarks that are important to the analysis that follows: First, payment into the system is mandatory for all who are employed or self-employed. Second, a participant's benefits are unfunded and unsecured: They are simply a nonbinding promise by the state to pay some amount (which is subject to change) at some time (also subject to change) in the future.[2] Third, because a participant's ultimate benefit under the program is unfunded and

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[1]Congressional Budget Office, ''Social Security Privatization Experiences Abroad'' (Jan. 1999); Joint Committee on Taxation, ''Analysis of Issues Relating to Social Security Individual Private Accounts,'' JCX-14-99 (Mar. 15, 1999). *See also* Gregory N. Filosa, ''International Pension Reform: Lessons for the United States,'' 19 *Temp. Int'l & Comp. L.J.* 133 (2005).

[2]Federal courts have held that an individual claimant acquires no vested rights in gratuity-type benefits paid by the federal government to a veteran or his dependent. *See* Elmer F. Wollenberg, ''Vested Rights in Social-Security Benefits,'' 37 *Ore. L. Rev.* 360,

(Footnote continued on next page.)

unsecured, she can expect to receive her benefit (whatever that may be) whenever U.S. law entitles her to receive it. In sum, the programs are mandatory, publicly administered, unfunded, and unsecured.

Although the social security programs of many countries remain unfunded and unsecured, in the past two decades approximately 32 countries have modified their programs to provide that the mandatory withholding is deposited into a state-regulated account over which the participant has at least some investment control.[3] Australia and eight other OECD members have modified their social insurance programs in that manner.[4] In sum, those social insurance programs are mandatory, publicly regulated (although not publicly administered as in the United States), funded, and secured.

While there are many differences between the U.S. and Australian social security programs, our report focuses on the U.S. tax differences that result from the unfunded and unsecured nature of the U.S. Social Security program and the funded and secured nature of the Australian superannuation program. It identifies the overlaps and gaps between the Australia-U.S. income tax treaty[5] and SSTA[6] regarding the Australian superannuation fund[7] and provides recommendations for Treasury and the IRS to issue clarifying guidance to affected parties.[8]

There is considerable U.S. tax uncertainty for individuals subject to both programs regarding contributions to their Australian superannuation, accretions therein, and distributions therefrom. Income tax conventions and SSTAs between the United States and other foreign countries[9] endeavor to eliminate double taxation and harmonize the qualification of individuals for benefits of both systems. However, the evolutionary patchwork of those efforts, combined with a similar patchwork of U.S. domestic law, creates a body of law that can be nearly impenetrable in its complexity and at best results in uncertain tax liability for the taxpayer, tax entitlement for the sovereign, and withholding requirements for the employer.

When analyzing the U.S. tax consequences of state-mandated social insurance programs, it is tempting to classify them as deferred compensation arrangements and analyze them with the broad brush of section 83 (property transferred in connection with performance of services), sections 401 through 436 (deferred compensation, and so forth), and sections 3101 through 3128 (FICA). However, we believe to do so (without our recommendations) would be to overlook the purpose of the SSTAs and income tax conventions. Instead, those programs should be analyzed in a manner consistent with their true nature: the equivalent to U.S. Social Security.

While we focus on Australian superannuation law, our analysis applies equally to all countries whose state-mandated social insurance programs are covered by an SSTA, regardless of the similarity or difference between those programs and U.S. Social Security.

To harmonize the U.S. tax treatment of the Australian superannuation fund (and all social insurance programs subject to an SSTA) with the U.S. tax treatment of U.S. Social Security tax, we suggest that:

1) regulations under section 402(b) should be amended to clarify that arrangements subject to an SSTA are excluded from the statute;

2) regulations under section 83 should be amended to clarify that arrangements to an SSTA are excluded from the statute;

3) 31 C.F.R. section 1010.350(c)(4) should be amended to clarify that arrangements subject to an SSTA are excluded from reporting on Financial Crimes Enforcement Network Form 114, "Report of Foreign Bank and Financial Accounts" (formerly TD F 90-22.1, commonly referred to as the foreign bank account report);

4) regulations under section 6048 should be amended to clarify that arrangements subject to

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304 (1957-1958); *United States v. Teller*, 107 U.S. 64, 68 (1982); and *United States v. Cook*, 257 U.S. 523, 527 (1922).

[3]Barbara E. Kritzer, "Individual Accounts in Other Countries," 66 *Social Security Bull*. No. 1 (2005). The countries referenced in the bulletin include Argentina, Australia, Bolivia, Bulgaria, Chile, China, Colombia, Costa Rica, Croatia, Denmark, the Dominican Republic, El Salvador, Estonia, Hong Kong, Hungary, Italy, Kazakhstan, Kosovo, Kyrgyzstan, Latvia, Mexico, Mongolia, Nigeria, Peru, Poland, Russia, Singapore, Slovakia, Sweden, the United Kingdom, and Uruguay.

[4]The OECD member countries are Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The Commission of the European Communities takes part in the work of the OECD.

[5]Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, U.S.-Australia, Aug. 6, 1982, 35 U.S.T. 1999 [hereinafter "the tax treaty"], *as amended by* the Protocol signed on Sept. 27, 2001.

[6]Agreement between the Government of the United States of America and the Government of Australia on Social Security (Canberra, Sept. 21, 2001) (totalization agreement).

[7]*See* subsection 295-95(2) of the Australia Income Tax Assessment Act of 1997; *see also* T.R. 2008/D5 (June 4, 2008).

[8]The scope of this report is limited to identifying the U.S. income tax consequences of contributions, accretions, and distributions from an Australian superannuation fund to U.S. citizens and residents of Australia under current U.S. tax laws. It is not

(Footnote continued in next column.)

intended to provide a comprehensive analysis of the U.S. tax treatment of Australian superannuation schemes.

[9]The Mexico-U.S. agreement on social security was executed on June 29, 2004, but has not yet gone into effect.

an SSTA are exempt from reporting on Form 3520, ''Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts,'' and Form 3520-A, ''Annual Information Return of Foreign Trust With a U.S. Owner'';

5) regulations under section 3111 should be amended to clarify that accretions of benefits under social insurance programs subject to an SSTA are excluded from an individual's income in a manner similar to the exclusion of income in section 3111(c);[10]

6) reg. section 1.1298-1T(b)(3)(ii) should be amended to clarify that passive foreign investment companies owned by an arrangement subject to an SSTA are exempt from reporting on Form 8621, ''Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund''; and

7) if the foregoing suggestions cannot be adopted, the regulations under sections 901 and 960 should be amended to allow a taxpayer beneficiary of a superannuation fund a direct or indirect foreign tax credit for the Australian taxes he paid.

We believe Treasury and the IRS could implement our suggestions in a general legal advice memorandum or memorandum of understanding between the competent authorities.[11] Doing so would give Treasury time to make the recommended changes to the regulations while providing affected U.S. persons (USP) certainty of their tax and reporting positions without the fear of civil and criminal action for failing to file the aforementioned forms.

Several areas of the code and Treasury regulations already exempt social insurance programs of foreign governments from reporting obligations or taxation.

First, the preamble to the regulations under section 6038D[12] provides that an interest in social security, social insurance, or similar program of a foreign government is not considered a specified foreign financial asset and is therefore not reportable on Form 8938, ''Statement of Specified Foreign Financial Assets.''

Further, the preamble also contains a hyperlink to a chart that compares Form 8938 filing requirements with those required by FinCEN Form 114.[13] That chart indicates that social security program benefits provided by foreign government accounts are not reportable on either the FBAR or Form 8938, although, as noted in the third suggestion above, the regulations do not reflect that conclusion.

Second, reg. section 1.1298-1T(b)(3)(ii) provides that PFICs directly or indirectly held by trusts exempt from taxation as foreign pension funds exempt from tax under an income tax treaty are likewise exempt from reporting on Form 8621.

Third, reg. section 301.6114-1(c)(1)(vii) provides that filing of Form 8833, ''Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b),'' is not required to invoke the benefits of an SSTA.

Fourth, reg. section 1.409A-1(a)(3)(iv) provides that arrangements subject to an SSTA are exempt from the application of section 409A.

Fifth, section 3111(c) exempts wages paid by employers from the tax imposed by that section when an SSTA is in place.

II. Discussion

A. Reasons for Suggested Changes

Pension reform has been an active topic of discussion in nearly all OECD countries for more than a decade. The OECD published its first comprehensive survey of pensions across the 34 member countries in 2005.[14] In that survey, the OECD separated each member country's national retirement system into three tiers and analyzed the differences across them.

First-tier pensions in a country's pension scheme are mandatory programs designed to ensure that pensioners are provided some absolute, minimum standard of living. Second-tier pensions comprise mandatory earnings-based programs designed to achieve a targeted standard of living compared with the standard of living experienced while the individual was working. Third-tier pensions are voluntary programs designed to encourage savings for retirement.

This report focuses on second-tier pensions; specifically, the U.S. tax classification of Australia's second-tier pension (the superannuation guarantee or SG).

[10] Section 3111(c) provides: ''During any period in which there is in effect an agreement entered into pursuant to section 233 of the Social Security Act with any foreign country, wages received by or paid to an individual shall be exempt from the taxes imposed by this section to the extent that such wages are subject under such agreement exclusively to the laws applicable to the social security system of such foreign country.''

[11] Although several of the cited statutes do not delegate legislative rulemaking authority to Treasury, we believe the recommended clarifications are within the IRS's authority to enact interpretative regulations, subject to the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. section 553.

[12] T.D. 9706.

[13] *See* http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

[14] OECD, ''Pensions at a Glance 2005'' (2005). *See also* OECD, ''Pensions at a Glance 2013: OECD and G20 Indicators'' (2013).

The second-tier pension scheme in the United States is publicly administered by the IRS and the Social Security Administration as an unfunded and unsecured promise to pay an undeterminable amount in the future. That is similar to the second-tier pension schemes in most OECD countries. In contrast, the second-tier pension schemes in Australia, Chile, Estonia, Israel, Mexico, Norway, the Slovak Republic, Sweden, and Russia (not an OECD member) are generally privately administered as funded and secured plans. Because social security benefits for second-tier pensions in those countries are funded, there is near certainty that adequate contributions will be made.

The United States uses two types of international agreements to coordinate various aspects of its Social Security program: the U.S. model treaty and the SSTA. Coordination between the SSTA and the U.S. model treaty is addressed either exclusively through an executive agreement or in a treaty, or simultaneously in both. That bifurcated approach results in a legal patchwork that is sometimes overlapping, sometimes fails to address important areas, and is always complex for all stakeholders to administer and comply with.[15] As mentioned, the overlap between the Australia-U.S. tax treaty and the totalization agreement comes into sharp focus in the case of the Australian superannuation fund.

As a preliminary matter, we recognize that use of the term ''superannuation fund'' to describe the various forms of superannuation schemes in Australia is most likely a misnomer. Honorable Justice Graham Hill of the Federal Court of Australia has acknowledged that the term mistakenly suggests that every superannuation scheme is actually a fund.[16] He elaborated that this impression is untrue because most superannuation schemes in Australia ''are constituted by trust deeds, and in consequence they may be properly characterized as funds in which a member might be said to have an interest (using the word 'interest' in a non technical sense).''[17]

There is much diversity in superannuation schemes in Australia. However, for purposes of this report, we have intentionally opted to use the term ''superannuation fund'' as a generic reference for all types of superannuation schemes, which include many different types of superannuation funds. Consequently, we use the terms ''Super'' or ''Australian superannuation fund'' in the same way as the Australian tax legislation, to refer to a specific type of superannuation fund, which is a regulated fund that (1) is or was established in Australia or has any asset situated in Australia; (2) has central management and control of funds ordinarily in Australia; and (3) either has no active members, or at least 50 percent of the total market value of the fund's assets attributable to superannuation interests are held by active members who are residents of Australia.[18]

The Super is a taxpayer-specific government-mandated fund for all Australian workers, which aggregates contributions from three sources: mandatory employer contributions under the SG; concessional employee pretax contributions (the voluntary employee contribution or VEC); and non-concessional employee post-tax contributions (the after-tax contributions). However, the problem with the Super is that the tax treaty and totalization agreement do not clearly address the U.S. tax consequences of contributions to, accretions in, and distributions from a Super to a USP who is a member and beneficiary or to an Australian who is working in the U.S. and required to file a U.S. income tax return.

The pension-relevant provisions of the tax treaty under article 18 have not been significantly updated since it was ratified in 1983, despite the protocol, which was signed in 2001. Consequently, it insufficiently addresses the taxation of contributions, accrued income, and distributions from a Super (implemented under the Superannuation Industry Supervision Act of 1993).

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 on retirement or death, in consideration for services rendered in connection with past employment.

Hence, one could maintain that payments from the Super would constitute distributions from a foreign pension subject to tax in Australia and not the United States. That position must be considered in light of article 1(3), under which the United States reserves its right to tax U.S. citizens on a worldwide basis as if the tax treaty were not in force (the saving clause). The saving clause does not apply to social security (as defined in the tax treaty) received by a U.S. citizen resident in Australia.[19]

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[15] Allison Christians, ''Taxing the Global Worker: Three Spheres of International Social Security Coordination,'' 26 *Va. Tax Rev.* 81, 84-85 (2006).

[16] *See* Hon. Justice Graham Hill, ''The True Nature of a Member's Interest in a Superannuation Fund,'' 5 *J. Austl. Tax'n* 1 (2002).

[17] *Id.* at 2.

[18] *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 percent of the amounts that would be payable to or for 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, section 295-95(2)(c)(ii).

[19] *See* treaty article 1(4)(a).

The result could be that a USP who is a resident of Australia and a member and beneficiary of a Super (USP employee-beneficiary) is subject to tax in Australia and the United States on income from wages deemed constructively received from (1) SG contributions and VECs to the Super and (2) income accrued to the Super.[20] Alternatively, if the payments from the Super were classified as social security benefits, it is logical to conclude that contributions to and accretions in the Super should likewise be exempt from U.S. tax because the United States has ceded its ability to tax social security payments under article 18(2) of the tax treaty.

If analyzed under domestic U.S. tax law (without our recommended changes), contributions and accrued income in a Super would constitute part of a USP employee-beneficiary's worldwide income subject to U.S. tax while those amounts are also taxable in Australia. The basis for taxation arises because the Super represents an ''accession to wealth''[21] for the USP employee-beneficiary if the Super is classified as either a section 402(b) nonqualified retirement plan, an employee grantor trust under reg. section 1.402(b)-1(b)(6), or a foreign grantor trust under sections 671 through 679.

If the Super were analyzed as a section 402(b) plan, contributions — and in some circumstances, income accrued to the Super — would likely be subject to current income taxes, thereby resulting in substantial income tax liabilities for the USP employee-beneficiary (directly under section 402(b) or alternatively as an employee grantor trust under reg. section 1.402(b)-1(b)(6)), with no treaty relief available.

If, alternatively, the Super is treated as a foreign grantor trust under sections 671 through 679, all realized income and gains in the Super arising from superannuation assets would be attributed to the USP employee-beneficiary, resulting in income taxes and likely PFIC reporting obligations from investments held by the Super.[22] Although that option arguably results in lower current taxation to the USP employee-beneficiary up front, it effectively creates an ongoing burden in the form of more professional fees for the USP employee-beneficiary to fully comply with the complex U.S. tax reporting obligations.

We propose that if the USP employee-beneficiary of a Super ends up being double taxed by the application of section 402(b), Treasury and the IRS at the very least permit the USP to claim FTCs for Australian taxes paid by the Super under section 901 or 960 to alleviate the tax burdens incurred by the USP employee-beneficiary. If, alternatively, the USP employee-beneficiary were subject to double taxation (which could result if the Super is treated as a foreign grantor trust), we request that Treasury and the IRS clarify that the foreign taxes paid by the Super in Australia on contributions to it, and accretions on those amounts in the Super, also be creditable against U.S. income taxes of the USP employee-beneficiary.

In contrast to those two positions, we believe that SG contributions to a Super, as well as accruals and distributions therefrom, should not be analyzed as a nonexempt employees' trust, which would otherwise be subject to sections 83, 401(a), 402(b), and the like, but as consistent with the Super's true nature as a social security program.

We propose that the Super's classification relative to the SG be analyzed consistently with (and therefore be taxed similarly to) U.S. Social Security. As such, the SG contributions would fall outside the scope of section 402(b) because they do not arise from the employer-employee relationship but instead from Australia's taxing authority. Therefore, SG contributions, accruals, and distributions therefrom should not be classified as amounts transferred to the USP employee-beneficiary ''in consideration for the performance of services,'' and consequently, section 83 should not apply.

Even if section 402(b) were to apply to both the SG and employee components of the Super, which we do not believe is the correct conclusion, we maintain that contributions and accruals on a Super before distributions should be excluded from U.S. taxation as would be the case if the tax treaty were revised to incorporate article 18 of the 2006 and 2016 U.S. model treaties.

Article 18(2) and 18(4) of the 2006 model treaty and article 18(3) of the 2016 model treaty apply when the individual is a U.S. citizen and resident of the host country. They provide that contributions attributable to employment paid by or for the individual during the employment period to a pension fund are deductible or excludable in computing the individual's U.S. tax. Further, any accrued pension benefits or employer contributions attributable to employment made by the USP employer are not treated as taxable to the individual in the United States.[23] Those articles are excepted from the saving clause of both U.S. model treaties.

We also posit that the Super does not constitute a foreign grantor trust under sections 671 through 679 primarily because the USP employee-beneficiary in a Super is neither the grantor nor trustee of the Super and would not possess any discretionary powers and

[20]Under article 18 of the tax treaty, mandatory distributions from the Super that begin at the pension phase are subject to tax only in the United States and generally not in Australia.

[21]*See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955).

[22]*See, e.g.*, reg. section 1.402(b)-1(b)(6).

[23]*See* JCT, ''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,'' JCX-27-07, at 23-24 (May 8, 2007).

control over the Super under Australian law. Consequently, Australian social security benefits attributable to Super contributions, accruals, and distributions should be treated as foreign social security benefits. Further, because foreign social security payments are already excluded from U.S. taxation under article 18(2) of the Australia-U.S. tax treaty, we recommend that the same exclusion apply to social security contributions and accruals (before distribution), which could be clarified with an MOU between the competent authorities.

B. Background

1. U.S. and Australian Pension Systems

The lack of guidance on the tax classification and treatment of Supers presents an opportunity to propose a new framework for understanding from a U.S. tax perspective what a Super is, what it is supposed to achieve for Australians, how it operates, and whether it has any similarities to retirement vehicles in the United States. Addressing those questions requires a fundamental understanding of the prevailing retirement systems in Australia and the United States.

As noted in a 2015 OECD report,[24] both the United States and Australia have three-tiered retirement systems that consist of (1) a government pension system, (2) an occupational employment-based pension system, and (3) supplemental voluntary personal savings.[25] The first tier is a public pension, while the second and third tiers typically take the form of private pensions — namely, individual retirement savings accounts in the nature of funded and secured plans.[26] In a funded and secured plan, ''the employer typically contributes a specified percentage of the worker's compensation to an individual investment account for the worker. . . . Her benefit at retirement would be based on all such contributions plus investment earnings.''[27] In contrast, benefits under an unfunded and unsecured plan may be calculated under many different methods, and distributions are typically in the form of an annuity, lump sum, or a combination of both.[28]

Some observers have noted that to be eligible for adequate retirement income from those funded and secured plans:

> Employees need to ensure that significant contributions are made to those plans (the contribution phase), that those contributions are invested well and retained until retirement (the accumulation phase), and that the accumulated retirement savings are used to provide benefits throughout retirement (the pension phase).[29]

a. United States. The U.S. retirement system consists of a universal Social Security system, a voluntary occupational pension system, and supplemental voluntary savings.[30]

The primary U.S. Social Security program is the Old Age, Survivors, and Disability Insurance program, which provides monthly benefits to retirees, their dependents, and survivors, as well as to disabled workers and their dependents.[31] An employee contributes to these programs by working in employment covered by social security and paying the applicable payroll taxes. At retirement, disability, or death, monthly Social Security benefits are paid to insured employees and their dependents or survivors.[32] The amount of benefits may be adjusted for various reasons. The primary source of funding for Social Security benefits is federal payroll taxes imposed on an employer and its employees as well as on the self-employed.[33] The taxes are deposited in two separate trust funds: the Federal Old-Age and Survivors Insurance trust fund and the Federal Disability Insurance trust fund, which are financial accounts at the U.S. Treasury.[34] Money received by the trust funds can be used only to pay benefits and operating expenses of the Social Security program. Funds not currently needed for those purposes are invested in interest-bearing securities guaranteed by the federal government.[35]

Aside from Social Security, the United States has a voluntary pension system.[36] Employers are not required to provide a voluntary pension for their employees; however, those who choose to provide one are subject to the requirements applicable to each plan under the code and, in most cases, are subject to regulation under ERISA.[37] Most contributions, earnings on contributions, and benefits are not included in gross income

[24]*See* OECD, ''Pensions at a Glance 2015: OECD and G20 Indicators,'' at 123 (2015) (2015).

[25]Jonathan Barry Forman and Gordon D. Mackenzie, ''Optimal Rules for Defined Contribution Plans: What Can We Learn From the U.S. and Australian Pension Systems?'' 66 *Tax Law.* 613, 614 (2013).

[26]*Id.*

[27]*Id.* at 615.

[28]*Id.*

[29]*Id.* at 613-614.

[30]*Id.* at 617; *see also* JCX-14-99, *supra* note 1.

[31]*See* SSA, ''Social Security Programs in the United States'' (July 1997).

[32]Forman and Mackenzie, *supra* note 25, at 617.

[33]*Id.* at 618.

[34]*See* David Pattison, ''Social Security Trust Fund Cash Flows and Reserves,'' 75 *Soc. Sec. Bull*. 1, at 2-3, 7 (2015); and Dawn Nuschler and Gary Sidor, ''Social Security: Trust Funds,'' Congressional Research Service report 7-5700 (Apr. 25, 2012).

[35]SSA, ''Summary: Financial Status of the Social Security Trust Funds,'' at 21 (July 2015).

[36]Forman and Mackenzie, *supra* note 25, at 619 (*referencing* Forman, *Making America Work* 214 (2006); and Kathryn L. Moore, ''An Overview of the U.S. Retirement Income Security System and the Principles and Values It Reflects,'' 33 *Comp. Labor L. & Pol'y J.* 5,17 (2011)).

[37]*Id. See also* JCT, ''Present Law and Background Relating to the Tax Treatment of Retirement Savings,'' JCX-32-12, at 2 (Apr.

(Footnote continued on next page.)

until amounts are distributed, even if the arrangement is funded and benefits are vested.[38] The employer is entitled to a current deduction for contributions even though they are not currently includable in the employee's income.[39] Contributions and earnings are held in a tax-exempt trust, which enables the assets to grow untaxed.[40]

b. Australia. Australia's retirement system consists of a social security program to provide for retirement, survivors, and disability benefits; the SG, a mandatory superannuation system to supplement retirement plans; and supplemental voluntary savings.[41]

The Australian social security program consists of a flat-rate benefit funded from general revenues rather than from specific payroll taxes. The benefits cover retirement, survivor, and disability benefits, which may be reduced by both an income and asset test. The retirement benefits (referred to as ''age pension'') are a means-tested income support benefit for individuals at age 65. Generally, individuals must have lived in Australia for 10 years to qualify for full age pension benefits.[42]

The Australian pension system is also referred to as superannuation.[43] Employers, employees, and self-employed persons generally contribute to employer-funded pension funds administered by trustees. Those pension funds are typically funded and secured plans, although some unfunded and unsecured plans exist.[44] Generally an individual's superannuation balance cannot be accessed until reaching the ''preservation age,''[45] death, or disability.[46] The benefits accrued in the Super can then be taken as a lump sum, pension, or combination.[47]

The SG component of the superannuation scheme consists of SG contributions to private pension funds to supplement benefits payable under the social security program.[48] Commentaries on the Australian SG scheme have noted that all contributions are fully funded and fully preserved — that is, they must be kept together with investment earnings in superannuation funds until the statutory access age is reached[49] — vested, and portable.[50] The Australian Taxation Office (ATO) provides government oversight for the SG.

2. Superannuation Fund in Australia

a. Purpose of superannuation fund. The primary purpose of the superannuation system is to deliver income to enhance the living standards of retired Australians.[51] A superannuation fund is defined as ''an indefinitely continuing fund that is a provident, benefit, superannuation or retirement fund or a public sector superannuation scheme.''[52] The sole purpose of the fund is to provide real monetary benefits, or benefits of a monetary value, to members on retirement, death, or other cessation of employment.[53] Through it, the superannuation system also seeks to achieve (1) intergenerational equity, so that ''the increased cost of an ageing population are not fully borne by the generation that will be working in several decades' time when the dependency ratio is higher,'' as well as (2) ''income smoothing — to enable individuals to smooth their income over their lifetime, and thus maintain their standard of living once they retire.''[54]

13, 2012); JCT, ''Present Law and Background Relating to Tax-Favored Retirement Saving and Certain Related Legislative Proposals,'' JCX-3-16, at 4 (Jan. 26, 2016).

[38]Forman and Mackenzie, *supra* note 25, at 619-620. Also, many distributions can be rolled over to another plan for continued income deferral.

[39]*Id.* at 620.

[40]*See* JCX-3-16, *supra* note 37, at 4.

[41]*See* SSA Program Operations Manual System (POMS) section GN 01743.010; and Forman and Mackenzie, *supra* note 25, at 623.

[42]*See* POMS sections GN 01743.010, GN 01743.015(A), GN 01743.020.

[43]Forman and Mackenzie, *supra* note 25, at 624.

[44]*See* JCX-14-99, *supra* note 1.

[45]The preservation age is the earliest that retirement benefits can be paid from a Super and still get concessional tax treatment. Forman and Mackenzie, *supra* note 25, at 627.

[46]*Id.* at 27.

[47]*Id.* at 28.

[48]*See* POMS, ''Overview of the Australian Social Security System,'' at GN 01743.010.

[49]George Kudrna, ''Does Pre-Funding of Retirement Incomes Work? The Case of Australian's Superannuation,'' in ARC Centre of Excellence in Population Ageing Research and the Research Institute for Policies on Pension and Aging, *Pre-Funded Pension Plans: Theory, Practice, and Issues Does Pre-Funding Work — Abstracts* (Oct. 2013).

[50]*See* JCX-14-99, *supra* note 1, at II. *See also* CBO, ''Social Security Privatization: Experiences Abroad,'' at 46 (Jan. 1999).

[51]*See* Australian Law Reform Commission, ''Grey Areas — Age Barriers to Work in Commonwealth Laws,'' Issues Paper 41, at paras. 68-69 (Oct. 2012). *See also* Sam Henderson, *SMSF DIY Guide* 6 (2012), noting that a superannuation fund is a low-tax structure that would encourage Australian citizens to save for retirement so there would be less strain on the government to give everyone the age pension.

[52]*See* Superannuation Industry (Supervision) Act 1993 (SISA), section 10. Superannuation is governed by several commonwealth laws, including the SISA, Income Tax Assessment Act of 1997, Corporation Act of 2001, Tax Administration Act of 1953, and a variety of case law decisions from the ATO and other tribunals.

[53]*See* ATO, *supra* note 18, at para. 113, *citing Scott v. Commissioner (No. 2)*, 40 ALJR 265, at 272 (1966) (Windeyer, J.); *Mahony v. Commissioner*, 41 ALJR 232, at 232 (1967) (Kitto, J.); and *Walstern v. Federal Commissioner of Taxation*, 9003 FCA 1428, at paras. 53-54 (2003), 138 FCR 1 at 15-16.

[54]*See* Rami Hanegbi, ''Australia's Superannuation System: A Critical Analysis,'' 25 *Australian Tax Forum* 313, 312 (2010). *See also* Australian Law Reform Commission, *supra* note 51.

There are numerous types of superannuation funds, including corporate- or employer-sponsored funds,[55] industry funds,[56] retail funds and public funds,[57] public sector funds, small Australian Prudential Regulatory Authority (APRA) funds,[58] and self-managed superannuation funds.[59] Regardless of the type of fund, most Australians have their superannuation in an accumulation fund in which a member's superannuation benefits in retirement are based on the amount contributed by her employers, the amount she voluntarily contributed, and the amount earned by the superannuation fund investing the contributions.[60]

Superannuation funds, along with other superannuation entities,[61] are regulated under the Superannuation Industry (Supervision) Act 1993 (SISA) and its Regulations (SISR) (collectively, SIS legislation).[62] SISA arises under the pension and corporation powers of the Australian constitution.[63] As a consequence, funds and trusts regulated under those powers are eligible for tax concessions if they are complying superannuation funds.[64] For a fund to constitute a complying superannuation fund under SISA, it must have (1) either a constitutional corporate trustee (the corporations route)[65] or its governing rules must provide that the sole or primary purpose of the fund is the provision of ''old age pensions''[66] (the pensions route);[67] and (2) the trustee must give APRA or the ATO an irrevocable election for the fund to become regulated under SISA.[68] A regulated superannuation fund that is at all times a ''resident regulated superannuation fund'' during the year of income is classified for Australian income tax purposes as an Australian superannuation fund (a Super) within the meaning of the Australian Income Tax Assessment Act of 1997 (ITAA97).

b. Resident Australian superannuation fund. The ATO commissioner has interpreted the definition of a Super for purposes of section 295-95(2) of ITAA97 as a regulated fund that (1) is or was established in Australia or has any asset situated in Australia; (2) has central management and control of funds ordinarily in Australia; and (3) either has no active members, or at least 50 percent of the total market value of the fund's assets attributable to superannuation interests are held by active members who are Australian residents.[69] An active

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[55]Funds established for the benefit of employees of the sponsoring employers or group of related entities.

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

[57]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 or companies.

[58]Funds with fewer than five members that are regulated by Australian prudential regulatory authority.

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

[60]*See* Australian Securities and Investment Commission, ''Types of Superfunds,'' 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.

[61]For example, the approved deposit fund and pooled superannuation trust are superannuation entities that are also regulated under SIS legislation. However, approved deposit funds are indefinitely continuing funds maintained by a registrable superannuation entity, a licensee that is a constitutional corporation solely for approved purposes — that is, to receive rollovers of superannuation benefits. Under SISA section 10(1), a pooled superannuation trust is treated as a resident unit trust (the trustee of which is a trading or financial corporation) used for investing in specified assets under SISA section 48.

[62]SIS is administered by Australian prudential regulatory authority, the Australian Securities and Investment Commission, 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.

[63]*See generally* SISA section 3(2).

[64]*See generally* SISA sections 3(2), and 19(2) to (4).

[65]*See Superannuation in Australia* (CCH), at para. 2-170. A constitutional corporation is a trading or financial corporation (as defined under para. 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 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 it 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.*

[66]An ''old age pension'' has the same meaning as para. 51(xxiii) of the constitution. It means a pension or annuity commencing at normal retiring age. The pension may be an allocated pension (and not a life pension) and may be payable by the fund or may be purchased from a provider using the member's benefit entitlements.

[67]Although the choice of the corporations or pensions route is optional, commentators have noted that some superannuation funds have no choice by virtue of their setup or structure because they are apparently required by SISA to have a corporate trustee in all cases (public offer superannuation fund) or a small superannuation fund with fewer than five members that is not a self-managed superannuation fund. *See Superannuation in Australia* (CCH).

[68]*See* SISA sections 19(2) to (4).

[69]*See generally* ATO, *supra* note 18. The alternative test is that at least 50 percent of the sum of amounts that would be payable to or for active members if they voluntarily ceased to be members is attributable to superannuation interests held by active

(Footnote continued on next page.)

member is a member who is a contributor to the Super or an individual on whose behalf contributions have been made.[70]

A Super is established in Australia if key elements are present: A trust deed for the Super is signed and executed,[71] and money or other property is transferred to the trustee of the Super as an initial contribution to be held in trust for the beneficiaries (members) of the Super.[72] The ATO uses principles of the general trusts law to determine when a superannuation fund was established, because most superannuation funds operate under a trust structure.[73] Indeed, the High Court of Australia has confirmed that the superannuation scheme is a ''strict trust''[74] and that a superannuation fund would not be an ''in truth discretionary trust.''[75]

The ATO determines the central management and control of a fund based on who makes the strategic and high-level decisions as well as when and where those decisions are physically made.[76] The ATO views the trustee of the Super as the party with the legal responsibility and duty for central management and control[77] because ''a trust is not a legal person but rather a collection of rights, duties and powers arising from the relationship to property held by the trustee for the benefit of beneficiaries.''[78] However, trustees of Supers are not the same as trustees selected by settlors who donate assets to a trust for trustees to administer gratuitously. Rather:

> Trustees of superannuation funds are typically corporations holding vast assets which they seek to administer in professional fashion under tight statutory regulation. The members are not volunteers or objects of bounty. Both employers and members contribute to the fund, sometimes pursuant to the contracts of employment and now, pursuant to statute law.[79]

Trustees generally derive their powers under the Super trust deed, with additional powers and duties conferred or imposed on them under SISA[80] and related legislation or state trustee laws.[81] The trustee must ensure that the Super is operated strictly in accordance with the trust deed and statutory requirements. Commentators have noted that those requirements present such a formidable task for the average Super trustee or member that in practice, most funds end up engaging specialized investment managers and tactical asset consultants for their investment activities.[82]

i. Contributions under Australian law. In a superannuation context, contribution is anything of value that increases the capital of a Super provided by a person whose purpose is to benefit particular members of the fund or all members in general.[83] Contributions include amounts such as direct cash payments by an employer or an individual to the fund; a transfer of property (or other asset) to the fund ''in specie'' by an employer or individual;[84] spouse contributions; government co-contributions; SG shortfall amounts[85] (discussed later);

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members who are Australian residents. *See* Income Tax Assessment Act of 1997, section 295-95(2)(c)(ii).

[70] *See* Income Tax Assessment Act of 1997, section 295-95(3).

[71] It is not necessary that the trust deed be signed and executed in Australia if the initial contribution made to establish the fund is paid and accepted by the trustee of the fund in Australia. *See* ATO, *supra* note 18, at para. 13.

[72] *Id.* An active member of a Super is a contributor to the fund or an individual on whose behalf contributions have been made. A contributor to the fund is ''an individual who makes a contribution for the purposes of providing for future retirement or superannuation benefits.'' *See* ATO, *supra* note 18, at paras. 184-189. If a member is a contributor to the fund at a particular time, she will be an active member regardless of whether she is an Australian or foreign resident.

[73] ATO, *supra* note 18, at para. 99, citing views expressed in *JD Mahoney v. FCT*; *Western Pty Ltd. v. FCT*; and *British Insulated & Helsby Cables v. Atherton*. *See also id*. at para. 119. *See also* ATO, supra note 18, at para. 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.''

[74] *See Finch v. Telstra Super Pty Ltd.*, HCA 36, at para. 66 (Oct. 20, 2010).

[75] *Id.* at para. 61.

[76] ATO, *supra* note 18, at 109-116, paras. 21-22. According to the commissioner, the everyday operational activities of the fund such as acceptance of contributions; the fulfillment of administrative duties; the investment of funds; and the preservation, payment, and portability of benefits do not constitute central management and control.

[77] *Id.* at 119, paras. 22-24.

[78] *Id.* at 119.

[79] *See Finch*, HCA 36, at para. 59.

[80] *See* SISA section 52B.

[81] The sole purpose test in SISA requires fund trustees to maintain the fund solely for the purpose of providing retirement or similar types of benefits to or for fund members. *See* ATO, *supra* note 18, at para. 112.

[82] *See Superannuation in Australia* (CCH); and *Commentary, Self-Managed Superannuation Funds Superannuation in Australia* (CCH). Members must have specific investment skills and expertise as well as awareness of SISA prudential requirements concerning investments. For example, SISA requires the fund to be maintained solely for one or more core purposes, have a properly formulated investment strategy, and comply with strict investment rules. Failure to satisfy SISA legislation may result not only in losing fund status (and tax concessions) but also in administrative and criminal penalties imposed on the trustees and anyone involved in the breach of the requirements.

[83] *See generally* ATO, *supra* note 18, at para. 1.

[84] *Id.* at para. 198, referencing section 285-5 of the Income Tax Assessment Act of 1997, stating the contributions can be or include a transfer of property.

[85] Amounts that form part of the SG charge collected by the commissioner and paid to a superannuation fund under SGAA92 when an employer fails to make sufficient superannuation contributions to a complying superannuation fund or retirement savings account. *See* ATO, *supra* note 18, at para. 198.

rollover superannuation benefits;[86] direct termination payments by employers as directed by employees;[87] and lump sum transfers from foreign superannuation schemes. However, the capital of the fund can also be increased indirectly.[88] But to be classified as a contribution, the increase must be intentional and purposeful.[89]

For the most part, a Super receives concessional and non-concessional contributions. Concessional contributions, also known as before-tax or deducted contributions, are included in the assessable income of the Super. Concessional contributions include employer contributions, both mandatory and voluntary, and most contributions made by self-employed persons.[90] Non-concessional contributions, also known as after-tax or undeducted contributions, are not included in the Super's assessable income. Non-concessional contributions include the member's personal contributions and contributions for a spouse. Another type of contribution consists of government contributions and co-contributions for low-income earners.[91] Our analysis focuses on (1) concessional employer contributions by and for an employer sponsor of the Super; (2) concessional employee contributions by or for a member of the Super; and (3) non-concessional contributions made by a member of the Super.

a. Mandatory employer contributions. Mandatory employer contributions are concessional superannuation contributions made by the employer for the employee under the SG scheme, which was introduced in 1992. The SG scheme requires employers to make contributions for their employees, equivalent to 9.5 percent of the employee's salary, which constitute ordinary time earnings.[92] Failure to make sufficient contributions by the due date and to the correct fund makes the employer liable for a nondeductible SG charge.[93]

Mandated employer contributions to the Super consist of (1) SG contributions, which are made by the employer to reduce the potential liability for the SG charge; (2) SG shortfall components, which are payments by the ATO to make up for any shortfall components of the SG charge; (3) award contributions made by the employer in satisfaction of its obligations under an industrial agreement or award; and (4) payments from Superannuation Holdings Accounts Special Account.[94] We collectively refer to the foregoing amounts as part of the SG contribution.

To be deductible to the employer,[95] SG contributions must be made to a complying Super specifically and solely for the purpose of providing superannuation benefits for the employee.[96] The following conditions must be present: (1) the contribution is made for a person who is an employee[97] and meets the employment activity condition for the employer's contribution to be deductible;[98] (2) the contribution is made to a complying Super; and (3) the contribution is made for an employee whose age is within the prescribed limit.[99]

b. Employee contributions. Employee contributions may be concessional or non-concessional. Employee concessional contributions are VECs made by the employee to the fund that constitute pretax deductions in the year they are made.[100] A deduction is allowable when the sum of assessable income, reportable fringe benefits, and reportable employer superannuation contribution to employment activities is less than 10 percent of the individual's total assessable income, total fringe benefits, and total employer superannuation contributions for the tax year.[101] Amounts attributable to employment include salary or wages, allowances, and other payments earned by an employee; commissions, director's fees, remuneration, and contract payments; employment termination payments, and worker's compensation and like payments.[102] VECs must be made to a complying superannuation fund solely for providing

[86]As defined under the Income Tax Assessment Act of 1997, section 306-10.

[87]Transitional termination payments cannot be received after July 1, 2012. *See* Income Tax Assessment Act of 1997, section 82-10F.

[88]For example, paying an amount to a third party for the benefit of the superannuation provider, forgiving debt owed by the superannuation provider, or shifting value to an asset owned by the superannuation provider. *See* ATO, *supra* note 18, at para. 11.

[89]To illustrate that, consider an increase in the fund's capital because of income, profits, and gains arising from use of the fund's existing capital. That increase will generally not be derived from someone whose purpose is to benefit particular members of the fund. *Id.* at para. 133.

[90]*See* Hanegbi, *supra* note 54, at 307 (for the proposition that the 15 percent concessional tax rate applies to most contributions by the self-employed).

[91]*See* Superannuation (Government Co-Contribution for Low Income Earners) Act of 2003 (Cth) (Austl.).

[92]*See* Robin Woellner et al., *Australian Taxation Law*, para. 23-030 (2013).

[93]*Id.* More details about the SG charge are discussed in the following sections.

[94]*Superannuation in Australia* (CCH), at paras. 39-240, 39-600, and 39-650.

[95]*See* Income Tax Assessment Act of 1997, subdivision 290-B (sections 290-60 to 290-100).

[96]*See* Income Tax Assessment Act of 1997, subdivision 290-B (section 290-10). *See also* ATO, *supra* note 18, at Part B, paras. 39 to 41. The conditions under sections 290-70, 290-75, and 290-80 must be satisfied for an employer to claim deductions for mandatory contributions made.

[97]Employee definition under common law and under the expanded definition of employee under section 12 of the SGAA.

[98]ATO, *supra* note 18, at Part B, paras. 53-56, referencing sections 290-65, 290-60(2), and 290-70.

[99]*See* Woellner et al., *supra* note 92.

[100]*See generally* Income Tax Assessment Act of 1997, subdivision 290-C for conditions that must be satisfied for deductibility.

[101]Income Tax Assessment Act of 1997, section 290-160.

[102]ATO, *supra* note 18, at paras. 62-64. *See also* Income Tax Assessment Act of 1997, sections 290-150 to 290-180.

superannuation benefits for the employee and dependents of the employee on the employee's death.[103] Self-employed individuals may, but are not required to, make personal contributions to their own superannuation fund. Those personal contributions may be deductible under some statutory conditions.[104]

Generally, employee non-concessional contributions are contributions made to the Super that are not included in the Super's assessable income. The most common type is the employee or member concessional contribution, which constitutes an after-tax voluntary personal contribution for which no income tax deduction is claimed.[105] Those include (1) contributions made for the person's spouse;[106] (2) contributions made in excess of the person's excess capital gains tax amount; (3) amounts transferred from foreign superannuation funds; (4) contributions made for the benefit of a person under 18 that are not employer contributions for that person; and (5) the person's excess concessional contributions for the year.[107]

ii. Investments under Australian law. Investment and activities engaged in by a Super are strictly regulated by an interlocking web of SIS legislation and other regulatory regimes[108] that impose ''quite rigorous regulatory standards.''[109] The High Court of Australia has commented on that aspect of the superannuation scheme, noting that because of the potentially lengthy periods over which superannuation savings are accumulated, it is ''natural that a trust mechanism would be employed and that taxation advantages of superannuation would not be enjoyed unless superannuation funds are operating efficiently and lawfully.''[110] Scholars have identified several broad investment principles that govern how funds are invested and specific prohibitions regarding fund investments.[111] For example, borrowing by the Super is strictly prohibited by SIS legislation and can be done only under specified circumstances.

Despite the variety of investment strategies available to a Super, it has been observed that most fund members do not exercise the choice to diversify and instead end up investing in default investment strategies by the fund.[112] As a result, most superannuation funds in Australia are combined in defined contribution schemes such that financial risks that include investment, longevity, and inflation risks are borne by the fund members and not covered by the Super.[113]

3. Australian taxation of superannuation fund. Although Supers are essentially trusts that hold superannuation assets, they are not taxed as trusts under Australian tax laws. A Super has special rules in place that modify general tax principles for calculating taxable income.[114] The starting point is always assessable income (excluding exempt income and non-assessable nonexempt income), from which deductions are applied to arrive at taxable income.[115] Complying Supers[116] in particular receive preferential tax treatment across three stages: contribution, accumulation, and pension. That means that not only will the Super be taxed at concessional rates but it will also be entitled to special deductions, exemptions, and other concessions.[117] In contrast, a fund that does not meet the definition of a superannuation fund will generally be assessed tax as a trust under the ordinary Australian trust tax law provisions.[118]

a. Contribution phase. The assessable income of a Super includes specific contributions.[119] During that phase, tax concessions available for contributions received by the Super include tax deductions for employer contributions and individual personal contributions; a tax offset for superannuation contributions made for the benefit of a contributor's low-income-earning spouse; and an entitlement to a government co-contribution when personal contributions are made by low-income earners.

As discussed, both SG contributions and VECs are included in the assessable income of a Super in the income year received. Those contributions are subject to a 15 percent contributions tax in the hands of the

[103]Income Tax Assessment Act of 1997, sections 290-150 to 290-180.

[104]ATO, *supra* note 18, at Part B, para. 57, referencing sections 290-150 and 290-160(1).

[105]Income Tax Assessment Act of 1997, subdivision 290-C.

[106]Spouse contributions can be made when the spouse is under 65 years old or has reached 65 but not yet 70 years and is gainfully employed part time. Income Tax Assessment Act of 1997, section 290-230.

[107]*Id.*

[108]The Australian prudential regulatory authority, chief executive Medicare, the Australian Securities and Investments Commission, the ATO, and the fair work ombudsman are regulatory agencies that share oversight of the superannuation fund industry.

[109]*Finch*, HCA 36, at para. 34.

[110]*Id.* at para. 35.

[111]*See* Forman and Mackenzie, *supra* note 25, at 42.

[112]Kudrna, *supra* note 49.

[113]*Id.*

[114]Robert L. Deutsch et al., *The Australian Tax Handbook* 1565-1566 (2014).

[115]*Id.* at 1565. The taxation of a superannuation entity is governed under division 295, Income Tax Assessment Act of 1997, which modifies general tax rules applied to a Super.

[116]*Id.* at 1566-1567. As noted, a complying Super is one that has received an unrevoked notice under SISA section 40 stating that it is a complying fund. For self-managed superannuation funds, compliance status is determined under SISA section 42.

[117]Deutsch et al., *supra* note 114, at 1566. Noncomplying Supers are taxed at 45 percent on all taxable income. *Id.* at 1568.

[118]*Id.* The governing trust tax law applied to a noncomplying Super is division 6 of Pt. III ITAA 1936, under which the Super will be taxed as a trust or a public trust (if applicable).

[119]*Id.*

Super.[120] SG contributions and VECs are subject to a yearly cap of $30,000 (or $50,000 for members age 49 or older). SG contributions in excess of the concessional contributions cap for the year are included as assessable income, which is then taxed at the employer's marginal tax rates. Concessional employee contributions that exceed the annual cap amount are included in the individual's assessable income for the year.[121]

Non-concessional employee contributions — that is, additional after-tax contributions — are generally not included in the assessable income of the Super. However, the member is liable for tax on excess non-concessional contributions that exceed annual caps, which are indexed annually. Non-concessional employee contributions are capped at six times the concessional cap for the year.[122] Amounts exceeding the cap are taxed at 49 percent (for 2016 and 2017).[123] Members can also make additional ''bring forward'' non-concessional contributions over any three-year period until they turn 63 without incurring extra tax.

b. Accumulation phase. The Super remains subject to tax while the contributions are growing in the accumulation phase. In addition to the contributions tax, a Super's taxable income[124] is taxed at 15 percent if the Super is in compliance for that year.[125] Otherwise, the highest marginal tax rate will be applied, currently 47 percent. Taxable income of a Super includes contributions, ordinary earnings, capital gains, interest, dividends, and rent.[126] However, income earned from assets held by the fund to provide pensions benefits once the income stream begins is exempt from income tax as current pension income.[127]

c. Pension phase. In the pension phase, contributions plus earnings from investing those contributions less any Super expenses are usually paid in the form of member benefits when a member reaches the preservation age[128] and meets one of the conditions of release.[129] The preservation age is the earliest age that retirement benefits can be paid from a Super with concessional tax treatment. The preservation age varies for members depending on their date of birth. In the event of death before retirement, the member benefit is paid to the member's dependents.

Some conditions of release restrict the form of the benefit or amount of benefit that can be paid (a cashing restriction).[130] For example, the payment may be an income stream (pension) or a lump sum, depending on the circumstances. Payments to members that do not meet a condition of release are not treated as Super benefits; rather, they are taxed as ordinary income at the member's marginal tax rates.[131] The ATO views those events as incidents in which a benefit has been unlawfully released, and significant penalties apply.[132]

If the Super has paid tax on contributions and earnings, benefits paid either as lump sum or pension are generally tax free for people age 60 and over. However, when the Super has not paid tax on contribution and earnings, the benefits it pays are taxed.

C. SG Scheme as Equivalent to Social Security Tax

1. SG Background

a. SG scheme. As mentioned, all employers in Australia are required to make superannuation contributions into a complying superannuation fund or retirement savings account for the benefit of their eligible employees in accordance with minimum prescribed levels. The minimum level of employer contributions is administered by the ATO under the SG scheme of the Superannuation Guarantee (Administration) Act of 1992 (SGAA), its regulations, and the Superannuation Guarantee Charge Act of 1992 (SGCA).

The superannuation system was traditionally a system of voluntary private pensions provided through employers that was expanded in the 1980s and 1990s. The first expansion, called the Award Superannuation, was sought by the labor unions spearhead by the Australian Council of Trade Unions (ACTU) seeking a universal 3 percent employer contribution to a pension fund instead of a wage increase. The central wage bargaining that took place in 1985 and 1986 resulted in an

[120] *See* Income Tax Assessment Act of 1997, subdivision 290-C.

[121] Income Tax Assessment Act of 1997, section 291-15. Also, for years before July 1, 2014, the individual must pay an excess concessional contributions charge on the increase in the tax liability as a result of having excess concessional contributions for the relevant year. *See* Superannuation (Excess Concessional Contributions Charge) Act of 2013.

[122] Income Tax Assessment Act of 1997, section 292-85(2). For members age 65 but less than 75, the cap is $180,000 for 2015-2016. For members under age 65, the cap is $540,000 over a three-year period.

[123] Income Tax Assessment Act of 1997, sections 292-80 and 292-85(1).

[124] *I.e.*, both ordinary and statutory income derived from all sources.

[125] Deutsch et al., *supra* note 114, at 1567.

[126] *Id.* at 1570.

[127] *Id.* at 1582.

[128] Access to benefits in a Super is generally restricted to members who have reached preservation age, which ranges from ages 55 to 60.

[129] *See* Schedule 1 of the SISR for a table specifying the conditions of release and the cashing restrictions. *See also Superannuation in Australia* (CCH), at para. 8-110 et seq.

[130] *See* Schedule 1 of the Superannuation Industry (Supervision) Act of 1993 (SISR) and its regulations. There are no cashing restrictions in the event of retirement, death, terminal medical condition, or permanent incapacity, or upon reaching age 65. However, cashing restrictions apply to all other circumstances.

[131] *Superannuation in Australia* (CCH), at para. 12-500.

[132] *Id.* at para. 8-270 et seq.

agreement between employers and labor unions that has been incorporated into employment contracts since June 1986. The second expansion, called the Superannuation Guarantee (SG), took place in 1992, when the government mandated employers to provide superannuation to workers through contributions that are vested immediately and fully portable. Although the proposal originally envisioned a matching contribution from the government, this provision was replaced with a tax rebate effective in fiscal year 1999-2000.

In strict legal terms, the SGAA is structured as a piece of tax legislation, where employers who fail to make the correct amount of contributions are subject to a tax, which is imposed by the SGCA. The SGAA was structured in this way for constitutional reasons, as the Australian Constitution vests the powers that would be necessary to mandate employers to make contributions in the states rather than the federal government. In introducing the SGAA, the federal government relied on the taxing power as well as the pension power (as discussed further below).

The minimum level of SG contributions under the SG scheme is a prescribed percentage of the employee's ordinary time earnings in each quarter (charge percentage), subject to a maximum contribution base. The charge percentage is 9.5 percent until 2021. The maximum contribution base limits the employer's contributions by providing a ceiling on an employee's earnings base or salary in a quarter. For example, for 2015 and 2016, the maximum contribution base is $50,810 per quarter.

The SG contributions can be made to any complying superannuation fund or retirement savings account or to an approved clearinghouse that will forward the contributions to the appropriate fund.[133] Employers are required to offer employees their choice of fund for receiving the SG contributions or risk an additional increase in their SG charge liability as a ''choice penalty.''

An employer that fails to pay the prescribed rate of SG contribution in each quarter on a self-assessment basis is liable for the SG charge. An SG charge consists of the SG shortfall amount[134] plus interest and an administrative charge.[135] To avoid incurring the SG charge, an employer must make SG contributions by the 28th day after the end of the quarter. If there is an SG shortfall, the employer must lodge a statement with the ATO together with the SG charge payment. The SG shortfall component of the SG charge is generally paid by the ATO to a superannuation fund for the employee or the Superannuation Holding Savings Account (SHSA). An employer's failure to comply with its SG obligations may result not only in an SG charge liability also in an administrative penalty, general interest charge, or prosecution by the ATO. Unlike the SG contribution, an SG charge is not tax deductible to the employer.[136]

b. Under Australian law, the SG scheme constitutes a tax. It is undisputed that an SG contribution is a mandatory contribution by the employer of a percentage of its employee's salary to provide for the employee's own retirement.[137] The SG contribution itself, and accruals thereafter, do not constitute income to the employee in Australia,[138] even though they are paid to a Super that is intended to provide superannuation benefits for the employee in retirement. Rather, both the SG contribution amounts and accruals are taxed to the Super at a low rate of 15 percent. Distributions made by the Super during the pension phase are generally tax free to the employee.

If an employer fails to pay its required SG contributions to the Super, the difference between what is actually paid and what is owed (the SG shortfall) is charged to the employer by the commonwealth with interest and penalties — that is, the SG charge.[139] That charge is paid by the employer directly to the ATO and deposited into the Consolidated Revenue Fund and thereafter, the SG shortfall amount would be paid by the ATO to the corresponding retirement savings account, complying superannuation fund, or an approved deposit fund or SHSA for the benefit of the relevant employee in the amount of the SG shortfall.[140]

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[133]Employers with fewer than 20 employees may opt to make SG contributions through a clearinghouse.

[134]The SG shortfall amount is calculated by multiplying the employee's salary or wages for the relevant quarter by the reduced charge percentage — that is, the charge percentage less the level of superannuation support actually provided.

[135]Woellner et al., *supra* note 92, at paras. 23-810 and 23-820.

[136]*See generally* Income Tax Assessment Act of 1997, section 290-60.

[137]*Finch*, HCA 36, at para. 35. The High Court of Australia in *Finch* stated the purpose of the SG contribution as follows:

> A further factor is the public significance of superannuation. The federal government has attempted to reduce outflows by reducing the dependence of retired persons on the old-age pension funded out of general revenue. The taxation concessions now provided pursuant to Pt 3-30 of the *Income Tax Assessment Act* 1997 (Cth) are designed to encourage citizens to make provision for their retirement by investing in superannuation and to encourage their employers to create superannuation funds in their favor. The Parliament also has required employers to contribute a certain percentage of the employee's salary for these purposes.

[138]*See* ATO, *supra* note 18, at para. 104.

[139]*See* Taxation Administration Act of 1953, (Cth), Schedule 1, section 255-5(1)(a).

[140]*See* part 8 of the Superannuation Guarantee (Administration) Act of 1992 (Cth). The SG shortfall and interest component of the SG charge is paid by the ATO to the employee's superannuation fund and thus makes up for the delinquency in SG contributions of the employer.

However, SG shortfall component amounts paid by the ATO to the superannuation funds or accounts authorized by the SGAA are not actually payable to the employee until the occurrence of a pensionable event.[141] Indeed, in *Morgan v. Commissioner*, the High Court of Australia pointed out that the operative provision (section 65) of the SG scheme providing for payout of the SG Shortfall by the ATO ''does not provide for a payment of the amount of superannuation benefit directly to an employee. Rather, [section 65] provides for payment to a fund to be held against the invalidity or old age of the employee.''[142]

For those reasons, the High Court ultimately concluded that the SG charge imposed by the SGCA and SGAA is an exaction for public purposes and is therefore a valid tax imposed on employers under section 51 (xxiii) of the Commonwealth of Australia Constitution Act, otherwise known as the ''Pension Power.''[143] The SG charge is a compulsory exaction to ''encourage all Australian employers to contribute to the financial needs of all Australian employees in old age or infirmity.'' Unlike an SG contribution, an SG charge is not tax deductible to the employer.[144]

2. Role of U.S. Totalization Agreements

An SSTA is an arrangement between the United States and another country under which both countries agree on which country will be responsible for the payment of retirement benefits to recipients who earned income and paid social welfare taxes to both countries.[145] The goal of U.S. totalization agreements is to maintain the coverage of as many workers as possible under the system of the country where they are likely to have the greatest attachment both while working and after retirement.[146] To that end, U.S. totalization agreements have two features: (1) relief from double taxation for social security taxes paid on the same employment or self-employment income, such that social security tax is paid to only one of the two countries; and (2) totalization of benefits, ''such that an individual who has paid social security tax in both countries may still qualify for benefits in one or both of the countries, even if there is not enough accumulated coverage to qualify for benefits in both of the countries.''[147] In Rev. Rul. 92-9,[148] the IRS stated that totalization agreements provide for rules to maintain an employee's coverage ''under the system of the country where the work is performed and exempting the employee from coverage and taxation in the other country.''

The IRC itself provides for exemptions for FICA and the Self-Employment Contributions Act (SECA) taxes when a totalization agreement is reached between the United States and the foreign country where the USP has contacts.[149] The following provisions were added to the code by section 317(b) of the Social Security Amendments of 1977: section 1401(c) (SECA), section 3101(c) (employee's share of FICA taxes), and section 3111(c) (the employer's share of FICA taxes).

It has been observed that the United States includes fewer programs in its social security agreements than other countries.[150] In fact, the only U.S. benefit program that can be affected by a U.S. totalization agreement is OASDI, while other countries include worker's compensation, cash sickness, maternity benefits, and family allowance programs.[151] To date, the United States has 25 totalization agreements.[152]

3. Australia-U.S. Totalization Agreement

Schedule 13 to the Social Security International Agreements Act of 1999 constitutes the Australia-U.S. totalization agreement.[153] It covers contributions made under the OASDI program; acts forming the social security law of Australia;[154] and the law concerning the

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[141] *See Roy Morgan Research Pty. Ltd. v. Commissioner*, HCA 35, at paras. 10-13 (Sept. 28, 2011) (interpreting section 65(1) of the SGAA).

[142] *Id.* at para. 91, explaining the effect of part 8 of the SGAA regarding section 65.

[143] *Id.* at paras. 93 to 94, concluding that the SG charge is a tax within section 51(ii) of the constitution for reasons stated in the text above.

[144] *Id.* at para. 74. The High Court of Australia stated: ''In our respectful opinion, an exaction, for the purposes of which is to encourage all Australian employers to contribute to the financial needs of all Australian employees in old age or infirmity is an exaction for public purposes.'' *Id.*

[145] These agreements are referenced as totalization agreements because they allow workers to aggregate or ''totalize'' periods of coverage to qualify for social security benefits. *See* Mickey Davis and William Streng, *Retirement Planning: Tax and Financial Strategies*, para. 21.02[2].

[146] *See* Paul Butcher and Joseph Erdos, ''International Social Security Agreements: The U.S. Experience,'' 51 *Soc. Sec. Bull*. 72 (Sept. 1999).

[147] *Id.*

[148] 1992-1 C.B. 344.

[149] Sections 1401(c) (SECA), 3101(c) (employee's share of FICA taxes), and 3111(c) (employer's share of FICA taxes) grant an exemption from the payment of Social Security taxes when a totalization agreement is in place. Those exemptions were added to the code by section 317(b) of the Social Security Amendments of 1977. *See* Rev. Proc. 80-56, 1980-2 C.B. 851, *amplified by* Rev. Proc. 84-54, 1984-2 C.B. 489.

[150] Butcher and Erdos, *supra* note 146, at 9.

[151] *Id.*, noting that section 233 of the Social Security Act allows additional provisions to be made to social security agreements that are not inconsistent with Title II (federal OASDI).

[152] *See* https://www.ssa.gov/international/agreements_overview.html.

[153] *See* Schedule 13 to Social Security (International Agreements) of 1999 — Agreement between the Government of Australia and the Government of the United States of America on Social Security, U.S.-Australia (Oct. 1, 2002).

[154] Age pension, disability support pension for the severely disabled, pensions payable to widowed persons, and career payment. *See* article 1(b)(i) of the totalization agreement.

SGAA, the SGCA, and the SGAR.[155] The Social Security Administration (SSA), Treasury, the Justice Department, and the IRS have acknowledged the need to eliminate overlapping social security coverage (dual social security coverage[156]) and double taxation of social security contributions between Australia and the United States, including the Australian SG program.[157]

a. Totalization of benefits. The provisions of the Australia-U.S. totalization agreement permit people to qualify for social security benefits based on combined U.S. and Australian coverage credits limited to the following types of benefits: U.S. retirement, survivor, and disability benefits under title II of the Social Security Act (except Medicare benefits,[158] Supplemental Security Income, or special age 72 benefits);[159] and Australian social security retirement, survivor, and disability benefits.[160] The scope of benefits under the totalization agreement is limited to OASDI benefits under U.S. law and does not cover Medicare benefits.[161]

b. Elimination of double taxation. The provisions of the Australia-U.S. totalization agreement that eliminate double taxation of salary or wages apply to U.S. Social Security taxes (including the Medicare tax portion[162]) and Australia's SG contributions.[163]

The SSA's explanatory annotations to Congress regarding article 2(b) of Part II of the Australia-U.S. totalization agreement reflect the agency's view that SG contributions are equivalent to U.S. Social Security taxes (FICA and SECA):

> For Australia, the Agreement applies to the laws on the Social Security benefits listed in Article 2.1(b) (i) and to the laws on Superannuation Guarantee (SG) in Article 2.1(b) (ii). The ''age pension'' referred to in Article 2.1(b) (i) (A) is payable at age 65 to men and age 61½ (as of 2001) to women and is referred to in these annotations as an ''old-age pension.''
>
> In accordance with Article 1.1(e), the provisions of Part II of the Agreement, which eliminate dual Social Security coverage and taxation, do not apply to the Australian benefit programs listed in Article 2.1(b) (i) since these benefits are financed entirely from general revenues and not from earmarked payroll taxes. Instead, Part II applies to the Superannuation Guarantee, which is the Government regulated program requiring employers either to pay contributions to employee retirement plans at specified minimum rates or pay a special SG Charge. As a result, when a worker is subject to U.S. laws and exempt from Australian laws in accordance with Part II, the worker's employer will be exempt from the SG requirements.[164]

The SSA's explanation provides clear guidance that under the Australia-U.S. totalization agreement, the employer and eligible employee would be exempt from making SG contributions (or their equivalent) in the

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[155] *See* article 2(b)(ii) of the totalization agreement.

[156] A dual social security coverage situation occurs when a person from one country works in another country by maintaining the employee's coverage under the social security system of the country where the work is performed and exempting the employee from coverage and taxation in the other country. *See* Rev. Rul. 92-9, 1992-1 C.B. 344; *see also* ''Withholding, Social Security and Unemployment Taxes on Compensation,'' Portfolio 392, at n.330 (citing 20 CFR section 404.190(a)).

[157] *See* POMS, ''Overview of the Australian Social Security System,'' at GN 01743.001. Treasury and the IRS share the same views as the U.S. Social Security Administration concerning the general function of totalization agreements, stating: ''These agreements are intended to minimize the potential application of two different employment taxes, and correspondingly coordinate the benefits under two different social security systems.''

See T.D. 9321, 70 F.R. 57939 (Oct. 4, 2005). Indeed, Treasury and the IRS in the preamble expressed their view that amounts contributed or benefits paid under a foreign social security system by a service provider that is the subject to a totalization agreement do not constitute nonqualified deferred compensation plans that would be subject to federal income taxation under the rules of section 409A. ''Benefits and other amounts deferred under a government mandated social security system, (which a service provider is entitled to receive under the foreign jurisdiction social security system) are not subject to Section 409A.''

[158] *See* Thomas Bissell, ''International Aspects of U.S. Social Security and Unemployment Taxes,'' Portfolio 6830, at Part III.

[159] Except sections 226, 226A, and 228 of Title II of the U.S. Social Security Act (42 U.S.C. sections 401 to 433). *See* totalization agreement, article 2(1)(a).

[160] *See* POMS, ''Scope of the U.S.-Australian Agreement,'' at GN 01743.110(A).

[161] *See* Bissell, *supra* note 158.

[162] For an excellent discussion on SSTAs, *see id*. at Part III(A); *see also* ''Online Annotation to Article 2(1) of the U.S.-Australia Totalization Agreement,'' https://www.ssa.gov/international/Agreement_Texts/Australia.html#part, which states:

> For the United States, the Agreement applies to title II of the U.S. Social Security Act and the corresponding tax laws (the Federal Insurance Contributions Act and the Self-Employment Contributions Act of 1954) and any regulations pertaining to those laws. However, the Agreement does not apply to Medicare provisions (section 226 and 226A of the Social Security Act) or provisions for special payments to uninsured individuals age 72 or over under section 228 of the Social Security Act. Persons to whom the Agreement applies who qualify independently for Medicare hospital insurance or age-72 payments will be entitled to receive such benefits.

[163] *See* POMS, ''Scope of the U.S.-Australian Agreement,'' at GN 01743.110(B).

[164] *See* U.S. Social Security Administration, ''Explanatory Annotations to Congress regarding Article 2(1) of the U.S.-Australia Totalization Agreement.''

United States if the employee is working there temporarily, so long as the employer continues making SG contributions for the employee in Australia. An example from the ATO confirms that:

> Jack is an Australian resident working in Australia for an Australian employer. His employer intends to send him to the United States to work for a year. Jack's employer must make compulsory social security (including Super) contributions for him under United States law. In addition, Jack's employer also must make super contributions for him in Australia. Before Jack leaves Australia, his employer requests a Certificate of Coverage from [the ATO]. This is to check and certify that the agreement between the United States and Australia applies to his situation. Jack and his employer are exempt from making contributions under United States law. However, Super contributions must continue to be made for Jack in Australia. Similarly, if an employee in the United States is sent to work temporarily in Australia and their employer has obtained a Certificate of coverage, they are exempt from Australia's super guarantee law and the employee and their employer must continue to make social security contributions under the United States' system.[165]

The above procedures fall within the preexisting operational framework established by the IRS to implement SSTAs entered into by the United States. Rev. Proc. 80-56[166] and Rev. Proc. 84-54[167] were issued to provide guidance on procedures for implementing the amendments to sections 1401(c), 3101(c), and 3111(c). The procedures require the USP to substantiate her exemption from FICA and SECA by obtaining from the authorized official or agency of the foreign country involved an affirmative statement that there is a totalization agreement between the foreign country and the United States; and that under that agreement, wages received or paid to the employee by the employer are subject to taxes or contributions under the system of that foreign country.[168] If the SSA-equivalent agency of the foreign country does not provide that statement, the SSA itself will issue a statement that the USP earnings are not covered by the U.S. Social Security system.[169]

The above revenue procedures indicate that the IRS was cognizant that SSTAs would exclude some income earned by U.S. taxpayers overseas from U.S. Social Security taxes if an equivalent foreign tax was being paid on those same amounts. It supports our position that for the Australia-U.S. totalization agreement, the SSA, the IRS, and the ATO were aware that the SG contributions would constitute foreign taxes equivalent to U.S. Social Security taxes and therefore must be incorporated into the SSTA to prevent inadvertent double taxation of the USP overseas income.

4. U.S. Social Security Taxes and Australian SG

As mentioned, Australia's superannuation scheme includes the SG, which is a privatized mandatory savings scheme that requires a minimum amount of contributions from employers for their employees.[170] All contributions are portable, fully funded, and fully preserved — that is, they must be kept together with investment earnings in the Super until the statutory access age is reached.[171] Once received by the Super, which are generally private sector entities, contributions are placed[172] in individual accounts and invested for the employees.[173] Fund investment earnings are added to superannuation assets that may be withdrawn on reaching the statutory eligibility age[174] and also used to compute eligibility for the age pension,[175] 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.[176] Indeed, it was anticipated that by 2005, payments from Australia's social security network would decrease substantially as payments from the Superannuation funds increased.[177]

Australia's expectation to replace the age pension with the superannuation fund to provide for retirement needs is reflected in the Social Security (International Agreements) Act of 1999 (SSIA),[178] which was enacted after the expansion of the Superannuation system in

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[165] *See* ATO, ''Bilateral Agreements — What Are My Super Obligations When My Employee Is Working Overseas?''

[166] 1980-2 C.B. 851.

[167] 1984-2 C.B. 489.

[168] *See* section 4.0 of Rev. Proc. 80-56, *as amplified by* sections 2.02 and 4.02 of Rev. Proc. 84-54.

[169] *Id.*

[170] Kudrna, *supra* note 49.

[171] *Id.*

[172] *See* Jerry W. Markham, ''Privatizing Social Security,'' 38 *San Diego L. Rev*. 747, 813 (2001).

[173] Kudrna, *supra* note 49.

[174] *Id.*

[175] Markham has observed that unlike Social Security, the 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* Markham, *supra* note 172, at 814, citing Centrelink, *Age Pensions: All You Need to Know* 4 (May 2000).

[176] *See* Markham, *supra* note 172, at 813, 814-819.

[177] *Id.*

[178] *See* Office of Parliamentary Counsel (Canberra), Social Security (International Agreements) Act of 1999, at Part 1(4)

(Footnote continued on next page.)

1992, which imposed mandatory employer contributions under the SGAA. The SSIA's scope references Australia's 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[179]) that would override Australian Social Security law.[180]

Closer scrutiny of the SG contribution amounts payable by an Australian employer under the SG scheme provides compelling similarities to a U.S. employer's mandatory payment of FICA and SECA taxes. The similarities between the SG, FICA, and SECA taxes are explained below.

a. Rate and computation of tax. Employers in the United States and Australia are both required to pay tax measured on the amount of wages paid regarding employment. Similarly, employers in the United States are required to pay an excise tax equivalent to 6.2 percent of their employees' gross wages up to an annual cap, as compared with the 9.5 percent of the mandatory SG contributions required from employers in Australia.[181] The employer portion of the FICA tax is computed by applying the rate in effect when wages are paid. That is the same computation for the SG contribution and the SG charge.

b. Collections and liability. Employers in the United States and Australia are both required to self-assess and remit the appropriate amount of tax. In Australia, employers remit SG contributions to the Super and pay SG charges directly to the ATO, which deposits them into the Consolidated Revenue Fund, where tax collections are deposited.[182] Failure to remit the SG charge is treated as an indebtedness owed by the employer directly to the commonwealth.[183] SG charges deposited into the Consolidated Revenue Fund are then disbursed by the ATO to the extent of the SG shortfall amount as payment to the applicable superannuation fund for the benefit of the relevant employee.[184] However, SG shortfall component amounts paid by the ATO to the superannuation funds or accounts authorized by the SGAA are not actually payable to the employee until the occurrence of a pensionable event.[185]

Employers in the United States also have a duty to compute, collect, and deduct the employee portion of FICA from the gross amount of the employee's wages. The employer then remits and pays the employer and employee portions of the FICA tax directly into the general fund of the treasury, where it is then appropriated to the OASI Trust Fund and the Disability Insurance Trust Fund.[186] The employer remains liable for the employee's FICA portion if it fails to withhold from its employee's wages and remit accordingly to the IRS (even if the employer has already remitted its portion of FICA), regardless of whether the tax is collected from the employee.[187] That is because liability for the FICA payment does not arise out of the employment contract but rather is created by the federal government's taxing authority.[188]

c. Indemnification. For the employee portion of the FICA tax, the U.S. employer is indemnified against all the claims and demands of any persons for the amount deducted and paid to the federal government.[189] Similarly, the Australian employer cannot be sued directly by the Australian employee for any unpaid SG contribution amounts determined to be owed to the employee's superannuation fund.[190] The SG charge is a debt payable by an employer to the commonwealth and may be recovered by the ATO commissioner directly against the employer.[191] In some cases, even directors may be personally liable for the unpaid SG liabilities of the

(compiled Jan. 1, 2016). The SSIA was enacted in March 2000 to form part of Australia's social security law.

[179] *See id*. at parts 2(5) and 2(6).

[180] *See* SSIA part 2.6(1), which states, "The provision of a scheduled international social security agreement have effect despite anything in social security law."

[181] *See* section 3111(a). *See generally Steward Machine Co. v. Collector of Internal Revenue*, 301 U.S. 548 (1937); and *Helvering v. Davis*, 301 U.S. 619 (1937).

[182] *Roy Morgan*, HCA 35, at para. 92.

[183] *See* Taxation Administration Act of 1953, (Cth) Schedule 1, section 255-5(1)(a).

[184] *See* part 8 of the SGAA. The SG shortfall and interest component of the SG charge is paid by the ATO to the employee's superannuation fund and thus makes up for the delinquency in the employer's SG contributions.

[185] *See Roy Morgan*, HCA 35, at paras. 10-13 (interpreting SGAA section 65(1)).

[186] *See* Rev. Rul. 81-211, 1981-2 C.B. 179. *See also Steward Machine Co. v. Collector of Internal Revenue*, 301 U.S. 548, 570 (1937); *Davis*, 301 U.S. 619, cases addressing constitutionality of Titles II and IX of the Social Security Act of 1935, imposing excise tax on employers. *See also* David Pattison, "Social Security Trust Fund Cash Flows and Reserves," 75 *Soc. Sec. Bull*. 1 at 2-3, 7 (2015); and Nuschler and Sidor, *supra* note 34.

[187] *See* section 3102(b); and reg. section 31.3102-1(d).

[188] *See* Rev. Rul. 81-211, 1981-2 C.B. 179.

[189] *See* section 3509; and Rev. Rul. 86-111. *See also Navarro v. United States*, 72 A.F.T.R.2d 93-5424 (W.D. Tex. 1993) (unreported opinion); *Umland v. PLANCO Financial Services Inc.*, 542 F.3d 59 (3d Cir. 2008) (FICA does not create a private right of action for a worker against her employer for a refund of employment taxes concerning her misclassification as an independent contractor); and *McDonald v. Southern Farm Bureau Life Ins. Co.*, 291 F.3d 718 (11th Cir. 2002). *But see Ford v. Troyer*, 25 F. Supp.2d 723 (E.D. La. 1998) (an employee has a private right of action against his former employer for alleged wrongful classification as an independent contractor insofar as the claim concerns failure to withhold FICA and federal unemployment taxes but not failure to withhold income taxes).

[190] *Superannuation in Australia* (CCH) at para. 12-420 et seq.

[191] *Id.* at para. 12-390 et seq.

corporate employer,[192] similar to the trust fund liability exposure of officers of U.S. employers that do not remit their FICA and other payroll taxes to the federal government.

d. Recap. There are substantial similarities between the U.S. Social Security taxes and the SG. The similar nature of those taxes has been acknowledged and placed within the scope of coverage of the Australia-U.S. totalization agreement. Indeed, FICA and SECA do not apply, while employee wages are subject to the social security system of a foreign country under a totalization agreement between the United States and that other foreign country.[193] FICA and SECA do not apply when a USP is subject to Australia's SG scheme. The SSTA confirms that the SG is in fact equivalent to U.S. Social Security taxes.

D. Section 61 Principles

1. Section 61 Should Govern Taxation of Supers

The pressing U.S. tax question concerning the Super is whether the SG contributions and VECs paid to the Super should constitute part of the USP employee-beneficiary's worldwide taxable income. From a high-level overview of the Super, it would appear that all concessional employer and employee contributions to the Super (and income accretions therefrom) are portable, fully funded, and fully preserved from the moment of contribution for the benefit of the USP employee-beneficiary. Tax practitioners appear to have fixated on that one aspect — the employer-employee relationship — as the dispositive basis for applying section 402(b) to a Super, even though Supers are not established exclusively by private contract between employers and their employees and are not foreign tax-deferred retirement plans.[194] Most importantly, the Australian courts and tax practitioners have themselves acknowledged the folly of analyzing a member's interests in a Super within the context of contractual rights arising from an employer-employee relationship.[195] Justice Graham Hill of the Federal Court of Australia has pointed out that a member's interest in a Super is blurred by the existence of two distinct legal relationships that simultaneously overlap in the Super — the first relationship governed by a deed of trust between the trustee, the trust property, and the beneficiary; and the second relationship arising from a plan between the employer and employee that reflects the terms of their contractual relationship.[196]

We believe that section 61 provides a more comprehensive framework for determining the taxability of the Super to its UPS employee-beneficiary for U.S. tax purposes. After all, both employer and employee contributions to the Super, at first blush, reflect a ''clear accession to wealth,''[197] even though those contributions are deposited into a fund or trust. To make that determination, the Super contributions and income accretions must be examined in light of the constructive receipt doctrine and economic benefit doctrine.

a. Constructive receipt. The question that arises under section 61 is whether a USP employee-beneficiary recognizes income when concessional contributions from the employer and employee are made to the Super and income accumulations accrue to that account (the accruals), even when the USP employee-beneficiary has not actually received that money or had access to those amounts. Reg. section 1.451-2(a) states that income is constructively received by a taxpayer when it is ''credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.''[198]

For decades, U.S. courts and the IRS have applied the doctrine of constructive receipt when the taxpayer has an unqualified, vested right to receive immediate payment of income[199] and has not delayed a payment that would otherwise be due to him.[200] Application of the constructive receipt doctrine to Super contributions and income would not result in any gross income attribution to the USP employee-beneficiary. That is because the Super has satisfactory title to all assets appearing on its annual statement of financial position, and those assets are held separately from assets of the Super's members, employers, and trustees.[201]

[192] *Id.* at para. 12-420 et seq.

[193] *See* section 3111(c), referencing section 233 of the U.S. Social Security Act. Self-employed individuals are also granted an exemption from taxes under SECA under section 1401(c). *See also* Rev. Proc. 80-56, *as amplified by* Rev. Proc. 84-54.

[194] As discussed in this report, contributions made to the Super and income accruing thereto are subject to current taxes in Australia, albeit at lower rates than ordinary income tax rates. Moreover, employer contributions paid directly to the Super as SG contributions are made under compulsion of Australian law and not voluntarily. The nature of those SG contributions is similar to U.S. Social Security, even though U.S. and Australian social security programs are administered differently.

[195] *See* Hill, *supra* note 16.

[196] *Id.* at 17.

[197] *See Commissioner v. Glenshaw Glass Co.*, 75 S. Ct. 743 (1955) (''Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion'').

[198] Reg. section 1.451-2.

[199] *See Ross v. Commissioner*, 169 F.2d 483, 490 (1st Cir. 1948).

[200] *See Gale v. Commissioner*, T.C. Memo. 2002-54. The tax court has noted that the doctrine of constructive receipt was conceived by Treasury to prevent a taxpayer from deliberately turning his back on the income and selecting a year in which to report it and reduce the same to possession. *Id.* (quoting *Hamilton National Bank v. Commissioner*, 29 B.T.A. 63, 67 (1933)).

[201] The assets of a superannuation plan may include contributions receivable, investments of the plan, cash and other monetary assets, and other assets used in the operation of the plan. See Australian Accounting Standards 25, section 27, at 16.

The Super's future obligation to fund a member's benefits on reaching preservation age is reported on its financial statements as a liability for accrued benefits.[202] Indeed, a USP employee-beneficiary has no immediate right to payment of amounts accumulated in the Super until the preservation age is reached. Once that age is attained, assets in the Super are liquidated and allocated to the member's account for distribution. The member then has an immediate right to payment of benefits from the Super, which he may opt to receive in a lump sum or periodically — at a minimum, he must withdraw at least 5 percent of the account balance yearly. Consequently, the member's right to payment of his Super benefits and control over the manner in which benefits are received at preservation age would support the assertion that the USP employee-beneficiary has actual and constructive receipt of gross income subject to U.S. taxation at his preservation age but not before that. We would argue that contributions and income accretions in the Super do not constitute gross income to the USP employee-beneficiary until those amounts constitute preserved benefits. Until then, there are several cashing restrictions that prevent the USP employee-beneficiary from obtaining unfettered access to and control over contributed amounts and income accretions in a Super. However, we are far from conceding the issue of the taxability of the Super at the pension phase. As more fully explained below, even a USP employee-beneficiary's access to the Super at the pension phase is not absolute, because there are also limits on the amount and type of benefits that can be distributed at that stage.

b. Economic benefit. The economic benefit doctrine has been called ''a limited technical device, created and advanced by the government in order to collect taxes from cash-basis taxpayers as soon as possible.''[203] Under that doctrine, a cash basis taxpayer recognizes income when he has acquired the economic benefit of money that is unconditionally and irrevocably transferred to him, although not necessarily accessible. The economic benefit doctrine is frequently applied to attribute income to a taxpayer-employee in deferred compensation arrangements when the employer has irrevocably set aside money in a trust, away from the employer's creditors, to benefit the employee.[204] In the seminal case of *Sproull v. Commissioner*,[205] the board of directors of a domestic company irrevocably transferred $10,500 to a trust to be paid out in two installments to a U.S. taxpayer who was the CEO of the company. The amount transferred constituted additional compensation to the CEO for work performed in prior years but underpaid by the company because of financial conditions. The court held that the expenditure of the $10,500 to set up the trust conferred an economic or financial benefit to the CEO in the year of transfer. The right to the trust was not contingent on any further action by the CEO, nor were there any restrictions on his right to assign or dispose of his beneficial interest in the trust. Moreover, no one else had an interest in or control over the money, except for the trustee, whose only duties were to hold, invest, accumulate, and pay out the fund and its increase to the CEO or his estate.

In determining whether an employer's SG contributions to a Super are taxable to a USP employee-beneficiary under the economic benefit doctrine, three elements must be present: (1) there must be some fund in which money or property has been placed; (2) the fund must be irrevocable and beyond the reach of the payer's creditors; and (3) the beneficiary must have vested rights in the money, with receipt conditioned only on the passage of time.[206] That means that only ministerial duties, not substantial restrictions or conditions, remain until the funds are released.[207] The third element is the most controversial for superannuation — that is, determining the nature of the beneficiary's interest in the monies contributed and accrued in the Super. The main contention is whether the USP employee-beneficiary has any vested[208] rights in the money, receipt of which is conditioned only on the passage of time as opposed to substantial restrictions or conditions.

Determining the true nature of a member's interest in Super (whether vested, contingent, or merely a right to be considered for benefits by the trustee) has perplexed Australian courts and practitioners for decades.[209] Hill has noted that the kind of superannuation scheme affects that determination.[210] For example,

[202]Financial statements of a Super are prepared as special purpose financial statements to meet the requirements of SISA and accompanying regulations.

[203]*See Thomas v. United States*, 45 F. Supp.2d 618, 625 (S.D. Ohio 1999).

[204]*See Pulsifier v. Commissioner*, 64 T.C. 245, 246 (1975) (citing *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd*, 194 F.2d 541 (6th Cir. 1952); and *Minor v. United States*, 772 F.2d 1472, 1474 (9th Cir. 1985) (citing Rev. Rul. 60-31, 1960-1 C.B. 174, 179)).

[205]16 T.C. 244.

[206]*See Thomas*, 45 F. Supp.2d at 620 (citing *Sproull*, 16 T.C. 244).

[207]*See Kuehner v. Commissioner*, 214 D. 2d 437, 440 (1st Cir. 1954), *aff'g* 20 T.C. 875 (1953).

[208]The term ''vested'' has different meanings depending on the context in which it is used. Vested amounts in a Super for Australian financial statement purposes are vested benefits that are not conditioned on the member's continued membership of the fund (or any factor other than resignation from the plan) and include benefits that members were entitled to receive if they terminated their fund membership at the end of the financial statement reporting period.

[209]*See* Hill, *supra* note 16.

[210]*Id.*

a member's interest in an accumulated benefits fund[211] on formation is an equitable property interest with no immediate right to payment.[212] That equitable interest is a conditional interest in the member's Super account balance under which the member has no right to the Super benefits until the conditions are met.[213] When the conditions are met, the member's interest is altered into two sub-interests: a right to immediate payment of the portion of the account balance that is not preserved, and a continuing conditional right regarding the portion of the account balance that is required to be preserved.[214] The preserved portion of the Super at the pension phase concerns specific benefits that may not be paid to the member until he retires from the workforce and attains a particular age or the benefits become payable in the event of one of the enumerated circumstances set out in the SIS regulations (for example, early retirement on grounds of incapacity, emigration from Australia, or early death before retirement).[215]

Compared to accumulated benefit funds, a member's interest in an end-benefit scheme[216] does not exist until the occurrence of the event that gives rise to the Super benefit.[217] Thus, each member's interest in the fund (regarding preserved benefits) is contingent on reaching retirement age before death.[218] The unresolved conflict with end-benefit schemes is whether trust beneficiaries, ''having more than a spec but less than an absolute interest,'' have an interest in each asset of the fund.[219]

Regardless of whether the fund is an accumulated benefits fund or an end-benefit scheme, Australian scholars have considered the true nature of a member's interest in the Super as either a contingent equitable interest that converts into a vested interest at the pension phase or a mere contractual right to Super benefits to be determined by the trustee. Arguably, neither constitutes a vested right to the Super's asset for purposes of the economic substance doctrine under U.S. tax laws, which requires a present, indefeasible right to the future receipt of property.[220] Indeed, the vesting of a Super's assets (benefits) on the USP employee-beneficiary does not depend on the making of any demand by or for the USP employee-beneficiary. That assertion is sound because a USP employee-beneficiary is not a party to the trust deed that formed the Super, and his rights as a beneficiary of the Super are not contractual in nature as others have jumped to conclude.[221] Australian courts have further elaborated on that aspect of a beneficiary's interest in a Super, noting that ''until a beneficiary under a superannuation fund becomes entitled to superannuation benefit, his or her equitable proprietary interest in the fund remains 'inchoate' and 'unchrystallised' so that neither the legal nor the beneficial owner of the amount that stands to the credit of his or her account from time to time.''[222]

Based on the above, we do not believe that a USP employee-beneficiary receives a present economic benefit when the Super is created by trust deed between the trustee and employer, or at the pension phase when the USP employee-beneficiary reaches retirable age, with only the passage of time as the sole condition left for his release. Nothing could be further from reality. There are additional conditions that may delay or hasten the release of money in a Super, particularly when amounts of money held by the Super are earmarked to be preserved unless a specific event occurs (such as death, incapacity, emigration from Australia, and other variables). Completely opposite from the foregoing is

[211]The accumulated benefits fund is apparently the earliest and simplest superannuation scheme in Australia. Contributions are made regularly by the employer and employee, and the accounts of the fund must record the contributions received separately for each member. The trust deed requires the trustees to invest contributions in authorized investments and allocates the income from those investments yearly to the accounts of members pro rata. Gains or losses are also allocated among members. When a member retires (or is incapacitated or some other defined circumstance), she is paid out of the fund an amount equal to her interest. When the member dies, a benefit is payable to her legal personal representative or dependents, and the benefits are calculated on the same basis as if the member retired rather than died. *Id.* at 13.

[212]*Id.* at 14-15 (quoting *Caboche v. Ramsay*, 119 ALR 215 (1993)).

[213]*Id.*

[214]*Id.* at para. 48.

[215]For example, the preservation standards in the occupational superannuation standards regulations (statutory rule no. 322 of 1987). Under those standards, the effect of preservation is that benefits are payable on the retirement of the member before attaining age 55 in the form or a non-commutable pension or annuity, no benefits may be paid to a member until she retires from the workforce and attains an age of not less than 55, or the benefits become payable in one of several circumstances identified in reg. section 11(1)(a)(ii).

[216]In an end benefit scheme, the trust deed requires the employer to make contributions from time to time in accordance with actuarial advice. To fund the benefits that the deed provides for employees and dependents, benefits may be based on final end salary, average salary over a period, or some other formula. *Id.* at 15.

[217]*Id.* at 15-16.

[218]*Id.* at 16.

[219]*Id.*

[220]*See Sproull*, 16 T.C. 244; *Kuehner*, 214 F.2d at 440; and *SWF Real Estate LLC v. Commissioner*, T.C. Memo. 2015-63, at *85. *See* Rev. Rul. 57-37, 1957-1 C.B. 18 (as modified by Rev. Rul. 57-528, 1957-2 C.B. 263); Rev. Rul. 72-25, 1972-1 C.B. 1271; and Rev. Rul. 68-99, 1968-1 C.B. 193.

[221]*See Caboche*, at paras. 62-63.

[222]*See Espasia Pty Ltd*. (ABN 74 057 517 825), in the matter of *Farm By Nature Pty Ltd*. (ABN 13 107 299 730) FCA 1552, at 229 (2009) (Gordon); *Re Coram*, 36 FCR 250, at 253-255 (1992); *Caboche*, 119 ALR 215 at 230; *Benson v. Cook*, 114 FCR 542, at 550-551, 561, 572 (2001); and *Cook v. Benson*, 214 CLR 370, at 35 (2003).

the scenario in which a USP employee-beneficiary at the pension phase is compelled to take out minimum distributions from the Super or risk incurring Australian taxes.[223] Those scenarios support the argument that a USP employee-beneficiary's interest in a Super at the pension phase remains unvested and confers no present economic benefit to the USP employee-beneficiary that would be subject to current U.S. taxation.

E. Sections 402 and 83 Regs Should Be Clarified

1. *Super Treatment Under Section 402(b)*

Under section 402(b), contributions by an employer to a nonexempt employee's trust are included in the employee's gross income when the employee's right to those contributions is no longer subject to a substantial risk of forfeiture as determined under section 83.[224] The amount includable in the employee's gross income equals the net fair market value of the employee's interest in the trust when vested.[225] Moreover, distributions received by the USP employee-beneficiary from a nonexempt employee's trust would be taxable to the USP employee-beneficiary in the year distributed or made available to that USP employee-beneficiary and limited only to the extent of that person's investment in the contract under section 72(w).[226]

As noted, we question whether section 402(b) applies at all to the Super. Section 402(b) requires an employer-employee deferred compensation arrangement — an employee's trust — to fall within its scope. Neither the IRC nor the Treasury regulations provide clear guidance on what constitutes an employee's trust.[227] Although the IRS has classified the Super as a foreign trust[228] for U.S. federal income tax purposes, whether the Super also constitutes an employee's trust for section 402(b) purposes remains unaddressed and therefore subject to interpretation.

The Super should not constitute an employee's trust and should therefore escape analysis under section 402(b) because it does not arise from a private contractual arrangement between an employer and employee like other typical (foreign and domestic) pension plans. The Super is mandated and created by Australian law, and neither the employer nor the employee can opt out of participation. The existence of the Super and SG contributions arise solely by virtue of Australia's taxing authority.

In the estate tax context, the IRS has acknowledged that accession to wealth arising from U.S. Social Security benefits should be treated differently from the accession to wealth that arises from an employment relationship. Rev. Rul. 81-182[229] states that U.S. Social Security benefits should be excluded from a decedent's estate because ''liability for payment does not arise out of the employment contract but rather is created by the Federal Government's taxing authority.'' Similarly, because the existence of the Super arises from the state's taxing authority, it should not be classified as an employee's trust.

Unlike other foreign trust arrangements in which the trustee is the legal owner of the trust assets and the employer is the settlor contributing cash or shares for employees,[230] the Super is established by executing a trust deed required under the SIS legislation along with an initial transfer of property to the trustee of the Super. Execution of the trust deed and the receipt of property give rise to the Super. The contributed property may come from the USP employee-beneficiary or other third parties, not necessarily the employer (although, in practice, the employer does contribute first). There is no mandatory or necessary employer involvement in the creation of a Super.

Even if the Super is classified as an employee's trust, one observer has noted that the legislative history of section 402(b) indicates that the statute was not intended to apply to foreign deferred compensation arrangements and instead was ''wholly focused on domestic tax qualified plans and perceived abuses with the U.S. tax-qualified plans by high ranking employees and shareholders.''[231] Indeed, in her outstanding review of the section 402(b) legislative history, Veena K. Murthy concluded:

> At no point in the history of section 402(b) has there been an indication that Congress, Treasury or the IRS intended to target and sanction foreign pension plans merely because they are funded plans that fail to satisfy sections 401(a)(26) and

[223] *See* Schedule 1 of the SISR, which sets out the conditions of release and cashing restrictions for purposes of the preservation rules. The preservation and payment rules are prescribed operating standards under SISA.

[224] Section 402(b)(1); reg section 1.402(b)-1(b)(2).

[225] Reg. section 1.402(b)-1(b)(2).

[226] Section 72 treats as nontaxable distributions amounts received by an employee that are attributable to the employee's ''investment in the contract.'' Section 72(w) provides that in determining the portion of a distribution includable in the gross income of a distributee who is a U.S. citizen or resident, the distributee's investment in the contract does not include any ''applicable nontaxable contributions'' or ''applicable nontaxable earnings.''

[227] The definition of foreign employees' trust under prop. reg. section 1.671-1(h)(2) fails to provide any definitive guidance on what constitutes an employee's trust. Indeed, the prop. reg. section 1.671-1(h)(2) definition provides a circuitous reference to sections 402(b) and 7701(a)(31).

[228] Section 7701(a)(30)(B); reg. section 301.7701-7. *See also* LTR 201538008, LTR 201538007, and LTR 201538006.

[229] 1981-1 C.B. 179.

[230] *See* Veena K. Murthy, ''Selected Cross-Border Equity and Deferred Compensation Issues with Funded Foreign Plans,'' 42 *Compensation Plan. J.* 67 (2014).

[231] *Id.*

410(b). Nor is there any indication that these legislative and regulatory bodies considered or targeted cross-border assignees . . . as persons who somehow abuse funded foreign plans to their benefit.[232]

The application of section 402(b) to foreign funded and secured pension plans is not unique to the Super. There are other non-U.S. trust arrangements potentially subject to the burdensome tax impact of section 402(b) on contributions and earnings. Those include the New Zealand superannuation plan; Dutch Stichtings; provident funds in Hong Kong Provident, Singapore, India, and Israel; Irish employee benefit trusts; U.K. employee benefit trusts; and arrangements within Swiss ''foundations.'' The main distinction, however, is that some of the countries have used totalization agreements and tax treaties to override section 402(b) consequences to a USP who has beneficial interests in a non-U.S. trust arrangement.[233]

If, despite the foregoing, the Super were to constitute an employee's trust that is subject to section 402(b), the next step of the analysis would be to determine whether the Super constitutes an exempt employee's trust under section 401(a). If the Super were classified as an exempt employee's trust, the SG contributions and VECs, as well as earnings accrued thereon, would be exempt from U.S. income taxation under section 501(a). Conversely, if the Super were classified as a nonexempt employee's trust under section 402(b)(1), the SG contributions and VECs, including earnings accrued, would be taxable to the USP employee-beneficiary as gross income if includable under reg. section 1.83-3 — that is, if those contributions are substantially vested or substantially nonvested.[234]

We acknowledge that if the Super were classified as an employee's trust to which section 402(b) applied, it would be extremely difficult or even impossible to be classified as an exempt employee's trust. Section 402(b) contains more than a few significant impediments to that classification. First is the fact that the Super is a foreign pension plan. Second is the general perception that most foreign plans are funded plans and that a funded plan has the same meaning for U.S. tax purposes as a funded plan in Australia.[235] Third is that for U.S. tax purposes, employer contributions to funded foreign pension plans constitute gross income to the employee, even though the employee's right to those contributions is deferred. Under section 402(b), the employee's right to employer contributions to the trust constitutes gross income to the employee when it is no longer subject to a substantial risk of forfeiture.

2. SG Contributions Should Be Excluded From 402(b)

The SG charge component of the Super provides further support to our suggestion that there is no employer-employee deferred arrangement subject to section 402(b). SG contributions made by the employer are compelled by statute under the SGAA. Any shortfall in SG contributions to the Super results in the SG charge — an excise tax owed by the employer to the ATO and paid directly to the collections revenue fund of the commonwealth. The ATO thereafter disburses the SG shortfall amount to the Super. There is no employee involvement with the SG contributions. It is a statutory obligation between the employer and the Australian Commonwealth, administered through the ATO. Indeed, the employee cannot bring a lawsuit against the employer for the SG shortfall amount, and the employer has no obligation to the employee regarding that amount. Rather, the SG shortfall amount results in an excise tax (the SG charge) to the employer. Based on the foregoing, it is apparent that the government (and not the employer) is the party actively involved in the contribution, investment, and distribution of the SG component to the USP employee-beneficiary.

There has been some concern among U.S. tax practitioners that the SG contributions made by the employer to the Super would constitute taxable wages to the U.S. member-beneficiary based on language found in Rev. Rul. 57-528[236] and Rev. Rul. 57-37.[237] In those revenue rulings, the IRS concluded that employer contributions to an unfunded and unsecured deferred compensation arrangement should be included in the employee's income based on the doctrine of constructive receipt.[238] As a result, the income constructively received was taxable to the employee under section 402(b) and, as a corollary, Treas. reg. section 1.402(b)-1(a)(1).[239]

One key distinction between the SG contributions and employer contributions in the above revenue rulings concerns the element of compulsion. As

[232]*Id.*

[233]*Id.*

[234]*See* reg. section 1.402(b)-1(a), (b), referencing reg. section 1.83-3(b) for the determination of whether contributions are substantially vested and substantially nonvested. *See also* T.D. 7554 (1978).

[235]Foreign pensions are perceived to be funded plans because assets are generally protected from the claims of creditors of the employer and related entities. *See* Murthy, *supra* note 230. An employee with an interest in a trust associated with a plan that is not a U.S. tax-qualified plan under section 401(a) is considered funded for U.S. tax purposes because the assets are protected from the claims of creditors and related entities. *Id.* (referencing LTR 8113107; Rev. Proc. 92-64, 1992-2 C.B. 422; and Rev. Proc. 92-65, 1992-2 C.B. 428).

(Footnote continued in next column.)

[236]1957-2 C.B. 263.

[237]1957-1 C.B. 18.

[238]The employer contributions conveyed fully vested and nonforfeitable interests into a separate independently controlled trust, forming part of a plan to provide unemployment and other benefits for its employees.

[239]*See* Rev. Rul. 60-31, 1960-1 C.B. 176, *as modified by* Rev. Rul. 64-279 and Rev. Rul. 70-435.

discussed, the employer's obligations to make SG contributions to a Super do not arise because of the employer-employee relationship but from Australia's taxing authority. In *Morgan v. Commissioner*, the High Court of Australia noted that the SGAA and SGCA:

> do not operate to substitute a new statutory obligation for a pre-existing private obligation in an employer to make a payment to any employee. Rather, the legislation exacts a payment from an employer; and that payment is paid to the Consolidated Revenue Fund. While payments from the Consolidated Revenue Fund pursuant to s. 65 of the SGA Act are made by the Commissioner for the ultimate benefit of individual employees, that benefit is only received by an individual employee in the event of infirming or retirement.[240]

In short, the SG contributions and SG charge imposed by the SGCA and SGAA constitute an exaction for public purposes[241] and therefore, a valid tax imposed on employers under section 51(xxiii) of the Commonwealth of Australia Constitution Act (aka the pension power).[242] That treatment is consistent with the USP employee-beneficiary's treatment of the SG contributions and SG charge as a nonevent for purposes of her own Australian tax liability. As mentioned, the SG contribution itself, and accruals thereafter, do not constitute income to the employee in Australia.[243] Ironically, however, that same exempt amount in Australia is constructively taxed to the USP employee-beneficiary by the United States.

The IRS has already determined that a compulsory levy and contribution made by a foreign employer under its domestic law constitutes a tax. In Rev. Rul. 89-104,[244] the IRS reviewed the compulsory 13 percent contribution imposed by the Saudi Arabian government on an employer under Saudi social insurance law (of which 5 percent could be paid by the employer by withholding 5 percent from an employee's wages), which were paid to the Annuity Branch[245] of the General Organization for Social Insurance Corp. (GOSI). The inclusion of foreign workers in the Annuity Branch was terminated by the Saudi government by royal decree in 1987, and GOSI issued benefit cancellation payments in exchange for an irrevocable surrender of rights to receive GOSI benefits. The IRS ruled that the contributions made by a U.S. taxpayer under a GOSI assessment while working in Saudi Arabia constituted taxes and were not made under an employer-employee contract. Hence, the mandatory employer contributions to the Annuity Branch for the employee did not create an investment in the contract for purposes of section 72(e) or basis for purposes of section 1001. Consequently, the GOSI benefit cancellation payments received by a U.S. taxpayer from the Saudi government constituted gross income under section 61(a), even though Saudi Arabia did not tax the GOSI cancellation payment. There is no tax treaty between the United States and Saudi Arabia that would have otherwise made the cancellation payments exempt from taxation.

The SG contributions of the Super bear an interesting similarity with the GOSI Annuity Branch assessments. Both are statutory obligations of employers to make contributions to provide for the old age, retirement, and death of its employees. Both are paid directly by the employers to the state and treated as a tax. The GOSI scheme is subject to control and change at the discretion of the state, and the SG is subject to strict regulation and administration by the ATO and various regulatory agencies.

Based on the above discussion and precedents, we suggest that the SG component of the Super is properly characterized as a foreign social security tax similar to or in the same nature as U.S. Social Security taxes, which are excise taxes on the employer for U.S. tax purposes[246] and are not derived as a direct result of a contractual employment relationship.

a. SG component of the Super constitutes a separate grantor trust. Because SG contributions are the foreign equivalent of U.S. Social Security taxes, both the earnings accrued in and distributions arising from the SG contribution portion of the Super would have been taxable but for article 18(2) of the tax treaty, which exempts social security benefit payments from Australia from U.S. federal income taxation.

We acknowledge that SG contributions under the superannuation scheme are distinct from FICA and SECA under the U.S. Social Security program. SG contributions to the Super are fully funded, fully preserved, and portable from an Australian perspective and arguably funded and secured from a U.S. tax perspective, whereas FICA and SECA tax payments are made for future U.S. Social Security benefits, which are unfunded and unsecured.[247] Indeed, in *Fleming v.*

[240] *Roy Morgan*, HCA 35, at para. 92.

[241] The SG charge was a compulsory exaction to "encourage all Australian employers to contribute to the financial needs of all Australian employees in old age or infirmity." *Id.*

[242] Commonwealth of Australia Constitution Act section 51(xxiii) (the power of the Parliament to make laws regarding invalid pensions and old age pensions).

[243] *See* ATO, *supra* note 18, at para. 104.

[244] 1989-2 C.B. 4.

[245] The Annuity Branch of the GOSI provides social insurance benefits for invalidism, old age (retirement), and death. The other branch of the GOSI, the Occupational Hazards Branch, provides insurance coverage for employment injuries and occupational diseases. *Id.*

[246] *See* section 3111(a).

[247] Indeed, federal courts have held that U.S. Social Security benefits are gratuity-type benefits paid by the government in which the individual claimant acquires "no vested rights." *See*

(Footnote continued on next page.)

Nestor,[248] the Supreme Court said the U.S. Social Security system is a form of social insurance in which the employee bears only a ''noncontractual interest'' such that the employee does not accrue property rights to Social Security benefits. It thus follows that U.S. Social Security contributions and accruals thereto are not taxed to the U.S. employee-beneficiary until those amounts are actually paid out.

We suggest that the funded and secured nature of the SG contributions in the Super does not constitute grounds for taxing contributions and accruals differently from contributions and accruals under U.S. Social Security.[249] Implicit in the SSTAs is that the foreign country's social security program is similar enough to the U.S. Social Security, and differences between the two do not justify different U.S. domestic tax treatment.

We agree with the House committee report to the Tax Reform Act of 1969, which found little practical difference between funded and unfunded deferred compensation:

> It is anomalous that the tax treatment of deferred compensation should depend on whether the amount to be deferred is placed in a trust or whether it is merely accumulated as a reserve on the books of the employer corporation. An employee who receives additional compensation in the form of a promise to pay him that compensation in the future made by a large, financially sound, corporation, is probably as likely to receive the compensation as an employee whose deferred compensation is placed in trust.[250]

SG contributions and accruals are preserved benefits in the Super that will not be payable to the USP employee-beneficiary until retirement age or, if earlier, until a condition of release is met. Until then, SG contributions are ''substantially nonvested.''[251] We are aware that it is likely that the nonforfeitability of the SG contributions in the trust triggers the current tax on the USP employee-beneficiary under section 402(b) because ''it embodies the taxation theory that when an employer contribution, which is placed in trust for the employee, is nonforfeitable at the time it is contributed, the employee has received an economic benefit that is taxable on a current basis.''[252]

However, we suggest that the there is no economic benefit to the USP employee-beneficiary derived from the SG contribution into the Super because it is not property of the employee until the requisite conditions of release are satisfied. Until then, SG contributions are property of the commonwealth. For example, in *Morgan v. Commissioner*, the High Court of Australia pointed out that the operative portion of the SG scheme (section 65) provides for the SG charge to be paid directly to the ATO, from which it is deposited into the government's revenue collections fund and not disbursed to the USP employee-beneficiary until specific conditions of release are satisfied:

> The SGA Act and the SGC Act do not operate to substitute a new statutory obligation for a pre-existing private obligation in an employer to make a payment to any employee. Rather, the legislation exacts a payment from an employer; and that payment is paid to the Consolidated Revenue Fund. While payments from the Consolidated Revenue Fund pursuant to s. 65 of the SGA Act are made by the Commissioner for the ultimate benefit of individual employees, that benefit is only received by an individual employee in the event of infirming or retirement.[253]

We note further that if the SG contributions are currently taxable to the employee based on the economic benefit rule, the value of the USP employee-beneficiary's interest in them does not equate to the FMV of the SG contributions at the time of transfer to the Super. Australian courts have described the nature of a beneficiary's rights in a superannuation fund as

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Wollenberg, *supra* note 2, at 304; *United States v. Teller*, 107 U.S. 64, 68 (1982); and *United States v Cook*, 257 U.S. 523, 527 (1922). U.S. agencies have argued before the Supreme Court that OASDI is a gratuity, because there is no express contract of insurance between the federal government and the individual payer of Social Security benefits. *See* Wollenberg, *supra* note 2, at 300 and 306. Department of Labor and Treasury submissions have reflected that view. *Id.* at 303. *See also Fleming v. Nestor*, 363 U.S. 603 (1960). That may be the only way to explain why thousands of individuals have qualified for OASDI benefits on the basis of earnings records when no Social Security taxes were paid and even when no tax liability was incurred. *Id.*

[248] *Nestor*, 363 U.S. 603.

[249] The seminal IRS guidance on deferred compensation, which would become the cornerstone for the taxation of funded and unfunded pension plans, is Rev. Rul. 60-31, 1960-1 C.B. 174, *modified by* Rev. Rul. 64-279, 1964-2 C.B. 121; and Rev. Rul. 70-435, 1970-2 C.B. 100. For insightful legal commentaries on the origins of the taxation of deferred compensation and legislative initiatives to abolish section 402(b)'s distinction between funded pension plans (current income inclusion) versus unfunded pension plans (no current income inclusion), see Commentary, ''Implementing Policy Objectives in the Taxation of Deferred Compensation Arrangements,'' 1978 *Duke L.J.* 1460 (1978); David R. Goode, ''Deferred Compensation Under the Tax Reform Act of 1969,'' 5 *U. Rich. L. Rev*. 235 (1970-1971); Ralph S. Rice, ''The New Tax Policy on Deferred Compensation,'' 59 *Mich. L. Rev*. 381 (1960-1961); and Richard S. Millerick and William A. Neilson, ''Non-Qualified Deferred Compensation After Tax Reform,'' 22 *Suffolk U. L. Rev*. 43 (1988).

[250] *See* H.R. Rep. No. 91-413 (part 1), at 89-91 (1969); and Goode, *supra* note 249, at 246. The House provision was deleted by the Senate at the request of Treasury, which indicated that the matter required further study and that alternative solutions would be preferred. Commentary, *supra* note 249, at 1475, referencing S. Rep. No. 91-552 (1969).

[251] *See* reg. section 1.83-3(b).

[252] *See* Commentary, *supra* note 249, at 1468.

[253] *See Roy Morgan*, HCA 35, at para. 92.

one that is of ''inchoate nature'' as first stated by the Federal Court of Australia in *Re Coram RA: Ex Parte Official Trustee in Bankruptcy and Ors*[254]:

> Until the happening of a prescribed event that will crystalize his right into an actual entitlement, a member of a superannuation fund is neither the legal nor the beneficial owner of the amount that stands to the credit of his account from time to time.[255]

Re Coram RA consolidated judicial dicta in various cases supporting the proposition that the current right of a member of a superannuation fund is no more than an expectancy.[256] His entitlements are all in the future and all depend on the occurrence of a prescribed event, of which the most common was the attainment of an agreed retirement age.[257] Indeed, a member's inchoate interest in a Super is such that a member-beneficiary of a superannuation fund has no direct interest in the underlying assets of the trust fund.[258] The beneficiary's interest is of an ''equitable proprietary nature, albeit one which does not carry an immediate right to payment.''[259]

If the SG contributions are classified as foreign social security taxes and benefits, which we believe is the correct treatment, the SG portion should fall outside the purview of section 402(b), which applies only to funded and secured pension plans that arise from a voluntary employer-employee contractual arrangement. None of the SG contributions constitute property transferred in connection with the performance of services between an employer and employee. Rather, the SG portion of the Super constitutes a separate and independent foreign trust (the SG trust). Both the commonwealth and the employer would be considered the grantors of the SG trust; however, only the commonwealth would be treated as owner of the trust.[260] The employer would not be treated as owner of the SG trust because the SG contributions would fail to qualify as gratuitous transfers if the employer is reimbursed by the commonwealth through tax deductions equivalent to those amounts.[261] It is the commonwealth, not the employer, that indirectly transferred property to the SG trust (through the employer).

We would further suggest that the SG trust constitutes a foreign grantor trust, with the commonwealth as grantor and owner. The commonwealth exercises dominion and control over the SG trust under the principles of sections 673 through 679 such that all SG contributions and accruals are attributable to the commonwealth as the owner and not to the USP employee-beneficiary. Further, the foreign grantor trust status of the SG trust satisfies section 672(f) and Treas. reg. section 1.672(f)-3 because the commonwealth has the power to re-vest SG trust assets back to itself. Ultimately, the SG contributions, accruals, and distributions should not be taxable to the USP employee-beneficiary, because they would constitute foreign social security taxes and payments thereon exempt from U.S. tax under article 18 of the tax treaty. Further, SG contributions and accruals constitute income to the commonwealth as the grantor-owner of the SG trust and not to the USP employee-beneficiary.

3. VECs Should Be Excluded From Sections 402(b) and 83

We do not believe that the SG portion of the Super alone is distinguishable from treatment as a foreign grantor trust with the commonwealth as foreign grantor-owner for the purposes of section 402(b). We maintain that the employee portion of the Super — that is, the VEC — is also not appropriately classified under section 402(b) in the absence of any employer-employee arrangement to defer compensation. The Super's structural framework varies significantly from other non-U.S. trust arrangements[262] in which the employee's right to the trust assets may be subject to service or performance conditions that must be satisfied for the employee's right to be nonforfeitable and for the employee to receive a future distribution of cash or a transfer of legal ownership in the shares from the trustee.[263] In our opinion, there are a few compelling reasons why the Super, while generically a funded and secured trust for the benefit of the USP employee-beneficiary, is unlike other private employer-funded foreign pension plans.

a. VECs to the Super do not fall under section 402(b). We believe that VECs made by a USP employee-beneficiary to the Super (and accruals on those contributions) should not be deemed gross income to that person under the constructive receipt doctrine, or the economic benefit rule of section 402(b), or the employee grantor trust rules of reg. section 1.402-1(b)(6). As stated, an employee-beneficiary's interest in a Super has been characterized by Australian courts as merely

[254] *In re Coram* and *Ors*, FCA 425 (1992).

[255] *Id.* at paras. 13-16.

[256] *Id.*

[257] *Id. See also* Hill, *supra* note 16.

[258] *See* M. Scott Donald, ''What's in a Name? Examining Consequences of Inter-Legality in Australia's Superannuation System,'' 33 *Sydney L. Rev*. 295, 302 (2011).

[259] *See Benson v. Cook*, FCA 1684 (2001), citing *Caboche*, 119 ALR 215, at 230 (1993).

[260] *See* reg. section 1.671-2(e).

[261] *Id.*

[262] *See* Murthy, *supra* note 230. According to Murthy, non-U.S. trust arrangements include Australian and New Zealand superannuation plans, arrangements within Dutch Stichtings, Hong Kong provident funds (as well as provident funds in other countries such as Singapore, India, and Israel), Irish employee benefit trusts, arrangements within Swiss foundations, and U.K. employee benefit trusts.

[263] *See* David W. Ellis, *Structuring International Transfers of Executives*, at section 27:5.01(c); and Murthy, *supra* note 230.

incipient, undeveloped, and inchoate,[264] as well as equitable and proprietary in nature but without an immediate right to the payment of benefits. Rather, the interest is merely the expectancy of future entitlements until the prescribed event occurs.

The nature of the USP employee-beneficiary's beneficial interest in the VEC, combined with the significant cashing restrictions, investment restrictions, and borrowing restrictions on the Super under SIS legislation, give support to our contention that USP employee-beneficiary's interests in a Super is indeed one that is substantially nonvested.[265] As discussed, there are investment restrictions, cashing restrictions, and conditions of release under SIS legislation that give us reasonable grounds to assert that the beneficial interest of the USP employee-beneficiary in the employee portion of the Super is nontransferable and remains subject to a substantial risk of forfeiture.

Indeed, a USP employee-beneficiary's entitlement to preserved benefits under the Super remains subject to revisions, repeal, and amendment by the Australian Parliament.[266] For example, a beneficiary's interests in the assets of a Super can be amended by the introduction of new bankruptcy laws that gave a bankruptcy trustee power to claw back amounts contributed to a Super by a debtor,[267] as well as by provisions in bankruptcy laws that limit exemption to a bankrupt's interest in a superannuation fund to a specified amount.[268] Consequently, amounts contributed and accruing in the Super remain subject to a substantial risk of forfeiture and are not transferable to any other party at any stage, even though contributions made to the Super are deemed fully funded, fully preserved, and portable.

Our understanding of the inchoate and incipient nature of a USP employee-beneficiary's interest in Super combined with the substantial restrictions prohibiting that person from accessing funds in the Super leads us to question whether the fully funded, fully preserved, and portable nature of the VEC is at all equivalent to the U.S. tax law concept of a funded pension plan, which section 402(b) is supposed to address. Section 402(b) provides that employer contributions to a nonqualified funded plan are not includable in the employee's gross income until his rights in the trust are transferable[269] or no longer subject to a substantial risk of forfeiture.[270] The code provides that the rights of a person in property are subject to a substantial risk of forfeiture if the rights to full enjoyment of that property are ''conditioned upon the future performance of substantial services by any individual.''[271] That does not apply to the Super because the SG contributions and VEC are not predicated on an employer-employee relationship such that the employee's rights to the Super are conditioned on future performance of services. Indeed, the Super does not fit into a typical funded pension plan under section 402(b).

For that reason, we hesitate to dwell further on section 402(b). We are concerned that applying reg. section 1.402(b)-1(b)(6) (the employee grantor trust rules) to the SG contributions and VEC in a Super would open a can of worms for the USP employee-beneficiary, because she would be treated as (1) the substantially vested USP employee-beneficiary of a foreign employer's contributions paid to a foreign non-grantor trust (the Super), and (2) the grantor-owner of a portion of the non-incidental employee contributions in a Super with uncertain tax consequences. That regulatory exception to section 402(b)(3) undermines legislative intent to restrain the application of the grantor

[264]Rudimentary, not fully yet formed, immature, incipient interest.

[265]Reg. section 1.83-3(b) defines property as being substantially nonvested when it is subject to a substantial risk of forfeiture and it is nontransferable. Conversely, property is substantially vested of those purposes when it is either transferrable *or* not subject to a substantial risk of forfeiture. Under reg. section 1.83-3(d), property is transferable if the person receiving the property can sell, assign, or pledge (as a collateral for a loan or as security for the performance of an obligation or for any other purpose) his interest in the property to any person other than the transferor of that property and if the transferee is not required to give up the property or its value if a substantial risk of forfeiture materializes. Reg. section 1.83-3(e) defines the term ''property'' as including a beneficial interest in assets (including money) that are transferred or set aside from the claims of the transferor's creditors — for example, in a trust or escrow account.

[266]Most recent changes to the Super were announced by the Australian government on September 15, 2016. These changes adopt the 2016-2017 budget proposal. The government decided to amend the package to provide greater support for Australians investing in their superannuation with the primary objective of providing an income in their retirement. The three changes announced by the government on September 15 are to replace the lifetime non-concessional contributions cap with lower annual caps for non-concessional contributions, only available to people with balances less than AUD 1.6 million; defer commencement of carryforward arrangements for concessional contributions; and not proceed with measures to increase the flexibility for contributions for people aged 65-74.

[267]*See* Australia Bankruptcy Act of 1966, sections 128A through 128N, introduced in July 2006 to enable trustees to void some superannuation contributions made with the intent to defeat creditors.

[268]*See* section 116(2)(d), 116(5)-(9) of the Superannuation Industry (Supervision) Consequential Amendments Act of 1993 (Act No. 82), the relevant part of which commenced in July 1994 as discussed in Victor J. Bennetts, ''Bankruptcy and Superannuation,'' 11 *Queensland U. Tech. L.J.* 157 (1995).

[269]One commentator has noted that the code provides a circular definition for the concept of what constitutes a nontransferable contribution to a trust, noting the ''the rights of a person in property are transferrable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.'' *See* Commentary, *supra* note 249, at 1467, n.44.

[270]The forfeitability requirement in section 402(b) is cross-referenced to the forfeitability requirements in section 83(a).

[271]Section 83(c)(1).

trust rules in a section 402(b) context. According to on observer, legislative history apparently indicates that section 402(b)(3) was enacted to clarify that income earned by a trust that remains undistributed to the employee would not be taxed to an employee before distribution, which ''in turn implies an intention or expectation that an employee would rarely be treated as grantor.''[272]

Further, the practical application of reg. section 1.402(b)-1(b)(6) would be extremely difficult, if not impossible, to administer for the Super regime. Reg. section 1.402(b)-1(b)(6) states:

> Where the contributions made by the employee are not incidental[273] when compared to contributions made by the employer, such beneficiary shall be considered to be the owner of the portion of the trust attributable to contributions made by the employer, if the applicable requirements of such subpart E apply [meaning the grantor trust rules].

Essentially, the above regulation provides an exception to the general rule under section 402(b)(3), which provides that the beneficiary of any trust under section 402(b)(1) would not be considered the owner of any portion of that trust under subpart E of Part I of subchapter J. Reg. section 1.402(b)-1(b)(6) carves out an exception to section 402(b)(3) when a beneficiary of a section 402(b) trust would be treated as a grantor-owner of that portion of the trust attributable to contributions made by the employee. If the regulation applies, earnings on the portion of the trust attributable to the employee's contributions are considered individual income and noncompensatory, such as capital gains or interest, depending on the nature of the earnings.[274] Yet there is no clear guidance on what would constitute an employee's contribution and an employer's contribution for that regulation and, more important, on what would constitute an incidental employee contribution.[275]

Aside from the difficulty in applying the above regulation to the Super because of 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 partially a section 402(b) nonexempt employees' trust and partially as 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 section 402(b) employee's trust, with income inclusion to be governed by sections 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 that it would render that requirement nearly impossible to satisfy.

Because SG contributions to the Super are mandatory and all employee contributions are voluntary or elective, one employee's Super might be treated only as a section 402(b) employee's trust because no non-incidental employee contributions have been made. Meanwhile, another employee may be required to bifurcate his Super and treat the SG contribution and the incidental employee contributions (not to mention related accretion inside the Super) as a section 402(b) employee's trust and treat the non-incidental employee contribution and related accretion as a foreign grantor trust. The bottom line is that someone would have to keep track of those bifurcated contributions and balances annually because the amounts and percentages of employee contributions may well vary from one year to the next. Of course, as a practical matter, many employees might forgo voluntary contributions to avoid that morass, a tendency that runs counter to the general policy of encouraging retirement savings.

4. Direct or Deemed Paid FTC

Without the clarifications we suggest in this report, U.S. tax law could be interpreted to require a USP employee-beneficiary of a Super to include in her gross income all the SG contributions, VECs, and accruals of income within the Super because it constitutes a funded and secured pension plan that is not subject to a substantial risk of forfeiture. In that event, we suggest that the USP employee-beneficiary of the Super should be allowed to claim either a direct or deemed paid FTC against her U.S. income tax for Australian taxes paid by the Super under article 22 of the tax treaty.

Our FTC suggestion is consistent with U.S. tax law. Section 901 allows a direct credit for the amount of income, war profits, or excess profits tax paid to any foreign country. Reg. section 1.901-2(a)(2) provides:

> A foreign levy is also considered an income tax, if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes. [However,] a foreign levy is not pursuant to a foreign country's authority to levy taxes to the extent a person subject to the levy receives (or will receive), directly or indirectly, a specific economic benefit from the foreign country in exchange for payment pursuant to the levy.

The above regulation declares that a tax or levy in exchange for which a governmental authority confers a specific benefit will not be considered a creditable tax. That differs from the more general benefits that taxpayers expect to receive from the government when it levies the tax. It is therefore reasonable to ask whether

[272] Murthy, *supra* note 230.

[273] One may question whether the IRS would be willing to rule on what amount or percentage constitutes an incidental contribution.

[274] *See* Murthy, *supra* note 230.

[275] *Id.*

social security taxes are too directly related to the specific benefits that the employee will receive in retirement.

Reg. section 1.901-2(a)(ii)(C) clarifies that a foreign levy imposed on individuals to finance retirement, old age, death, survivor, unemployment, illness, or disability benefits or ''for some substantially similar purpose'' is not a requirement of a compulsory payment in exchange for a specific economic benefit as long as the amounts required to be paid by the individuals subject to the levy are not computed on a basis reflecting the respective ages, life expectancies, or similar characteristics of those individuals.[276]

The foreign levy on the Super under SIS legislation is imposed on the SG contribution itself, the employee contribution, and accruals of income thereon at a rate of 15 percent on contribution and another 15 percent on accumulation. The levy is not based on the employee's age, life expectancies, or similar characteristics of individuals but on the mere fact that a contribution to the Super has been made to benefit the employee on retirement. Also, the 15 percent tax on contribution and accumulation may not be the only tax imposed if non-concessional contributions exceeding the annual cap amounts were also made that same year.

However, there are important distinctions regarding the Super taxes. First, Australia imposes the levy on the Super itself, SG contributions, employee contributions, and accrued income — not directly on the employer or the employee. Second, the SG contribution is mandatory to the employer whereas the VECs are not. The employee is not subject to a mandatory levy.

We do not believe that those distinctions, while important, are relevant to the scenario in which the USP employee-beneficiary is compelled by operation of sections 402(b) and 83 to include in her worldwide income all contributions made to the Super and accretions of income thereon. If the USP employee-beneficiary is to be taxed again by the United States for those same amounts under sections 402(b) and 83, or, in the alternative, as a grantor trust with the USP employee-beneficiary as grantor-owner under reg. section 1.402(b)-1(b)(6), it would follow that she should be able to claim either direct or indirect FTCs under section 901 or 960 against her U.S. income taxes for the Australian taxes paid by the Super on her VECs.

Our suggestion to extend an FTC to the USP employee-beneficiary for Australian taxes paid by the Super does not extend to the portion of the Super that constitutes SG contributions and accretions, because they constitute foreign social security taxes, which are not creditable under Rev. Proc. 80-54[277]:

> Section 317(b)(4) of the Social Security Amendments of 1977 provides that, notwithstanding any other provision of law, taxes paid by any individual to any foreign country with respect to a period of employment or self-employment that is covered under the social security system of such foreign country in accordance with the terms of an agreement entered into pursuant to section 233 of the Social Security Act shall not, under the income tax laws of the United States, be deductible by, or creditable against the income tax of, any such individual.

We do not anticipate contrary positions to be taken by the IRS regarding our proposal to extend FTCs to USP employee-beneficiaries of Supers for Australian taxes paid by the Super for the VECs and accruals thereto. Before the introduction of SSTA, the IRS ruled that foreign social security tax payments paid through employee contributions were generally creditable as compared with employer contributions.[278]

In 1977 Congress amended the Social Security Act to authorize the president to enter into SSTAs with foreign countries.[279] New subsections were simultaneously added to the code that deny an FTC to an individual who receives wages exempt from FICA or SECA under section 233 of the Social Security Act.[280] That disallowance has been affirmed in two cases involving the French *contribution sociale généralisée* and *contribution pour le remboursement de la dette sociale*.[281] Those tax payments were found to be social security tax payments of a foreign

[276]Reg. section 1.901-2(ii)(C).

[277]*See also* section 1401 to the Act of December 20, 1977, P.L. 95-216.

[278]*See, e.g.*, Rev. Rul. 68-411, 1968-2 C.B. 306 (Canadian social security tax payments ruled creditable); Rev. Rul. 69-338, 1969-1 C.B. 194 (Venezuelan social security tax payments ruled creditable to employees because of their compulsory nature but not on the employer's share of the payments that is not measured by the employer's income); Rev. Rul. 75-279, 1972-2 C.B. 441 (U.K. National Insurance Act taxes paid by U.S. employees ruled creditable but not the portion levied on employers). Both rulings were under section 901(a). The Supreme Court has held that the tax imposed by section 3101 was an additional income tax in cases challenging the constitutionality of federal employment and self-employment taxes. *Helvering v. Davis*, 301 U.S. 619, 635 (1937). *See also Cain v. United States*, 211 F.2d 375, 378 (5th Cir. 1954).

[279]Social Security Amendments of 1977, P.L. 95-216, section 317 (codified as section 233 of the Social Security Act, 42 U.S.C. section 433(a).

[280]P.L. 95-216, section 317(b)(2) (creating sections 3101(c), 3111(c), and 1401(c)); and P.L. 95-216, section 317(b)(4) (creating a note to section 1401, which denies the foreign tax credit). That curious approach to drafting the disallowance of the FTC was upheld in *Eshel v. Commissioner*, 142 T.C. 11 (2014), *appeal pending*; and *Erlich v. United States*, 104 Fed. Cl. 12 (2012). The purpose of those new provisions is to ensure that the U.S. employee subject to foreign social security tax is no better off than a U.S. employee subject to FICA payments. For tax payments made for U.S. Social Security, there is no credit granted against U.S. income tax. Similarly, there should be no FTC against U.S. income tax for payments for foreign social security.

[281]*Eshel*, 142 T.C. 11; *Erlich*, 104 Fed. Cl. 12.

country ''made in accordance with the terms of an agreement pursuant to section 233 of the Social Security Act.''[282]

The Australia-U.S. totalization agreement clearly identifies the SG as the other Australian social security tax that would be equivalent to U.S. Social Security taxes (FICA and SECA) in addition to the Australian social security taxes.[283] Hence, an argument could be made that the SG contributions to the Super should not be creditable to the USP employee-beneficiary. However, the Australian tax imposed on an employee's VECs or salary sacrifice is not within the scope of the totalization agreement. Therefore, the VECs (and accruals of income attributable thereto) should still be creditable for U.S. FTC purposes under either a direct or deemed paid credit mechanism, because they are exempted from U.S. Social Security taxes under sections 3101(c), 3111(c), or 1401(c). Thus, the note to section 1401 disallowing an FTC should not apply, and the older principles enunciated in the revenue rulings cited above should apply to permit a direct or deemed paid FTC for those Australian taxes if they otherwise correspond to items of income subject to current U.S. taxation.

F. U.S. Tax Law: Australian Superannuation Funds

1. Recent IRS Positions

The IRS recently published three private letter rulings concluding that a foreign trust providing superannuation benefits to its members constituted a trust for U.S. federal income tax purposes under reg. section 301.7701-4(a).[284] In all three letter rulings, the foreign social security arrangement was governed by foreign legislation and regulated by several government entities. The arrangement, which had the sole purpose of providing superannuation benefits to its members and their beneficiaries, was managed by individuals referred to in the letter rulings as trustees. All funds were derived from employer and employee contributions and from investment income. The trustees had a duty to manage funds responsibly to protect and preserve superannuation and provide an annual statement to beneficiaries stating 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.

A close reading of the letter rulings leads us to conjecture (without affirmation from the IRS) that they likely pertain to Australian superannuation funds. In the letter rulings, the IRS was asked to assume that the social security programs at issue were employee trusts for U.S. purposes. Therefore, it does not appear that the conclusion reached in the letter rulings depended on an analysis of whether the underlying arrangement was an employee trust. In light of our position that Australian superannuation funds should be analyzed consistently with U.S. Social Security and not as employee's trusts, we believe the rulings should be reexamined and clarified.

Reg. section 301.7701-1(a)(1) makes clear that the foreign classification of an entity does not control its classification under U.S. law.[285] In light of our suggestion that Supers are the equivalent of U.S. Social Security, we do not agree that the arrangements in the letter rulings should have been classified as foreign trusts for U.S. tax purposes, even though Australia views Supers as ''essentially trusts'' established to hold and invest in superannuation assets.[286] That is because Supers are creatures of Australian legislation and do not arise from private, contractual arrangements between an employer and employee or between a grantor trustee and beneficiary. General principles of Australian tax law were intentionally modified[287] to carve out a preferential tax scheme for Supers rather than impose ordinary trust tax law provisions applicable to ordinary and public trusts.[288]

We believe the Super's classification for U.S. tax purposes should be bifurcated into two components. The SG contribution (and accretions thereto) would constitute a foreign grantor trust (the SG trust) with the commonwealth as grantor of foreign social security taxes and benefits. The SG contributions and foreign social security taxes and accruals thereto (as social security benefits) would be exempt from U.S. income tax under treaty article 18(2).

The portion of the Super that corresponds to the VECs (and accretions thereto) would constitute a private IRA, with the USP employee-beneficiary as grantor-owner of the private IRA trust. As grantor-owner of a private IRA, contributions, accretions, and distributions would be subject to tax by the United States unless exempted under article 18 of the tax treaty. Unfortunately, the treaty does not have comprehensive pension provisions under article 18 to exempt a private IRA with a USP employee-beneficiary and grantor-owner from U.S. taxes. We would therefore

[282]Note to section 1401 under P.L. 95-216 (effective Dec. 20, 1977).

[283]*See* Australia-U.S. totalization agreement article 2: 1(b)(ii).

[284]LTR 201538008, LTR 201538007, and LTR 201538006.

[285]The regulation provides: ''The 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.''

[286]Deutsch et al., *supra* note 114, at 1566.

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

[288]Ordinary trusts and public trusts are taxed under division 6 of Part III of ITAA of 1936. *See* Deutsch et al., *supra* note 114, at 1566.

urge the IRS and Congress to fashion an administrative remedy for that problem so that only actual distributions from an Australian IRA would be taxable by the United States. That remedy could include an MOU between the competent authorities. With that remedy in place, all VEC amounts and accruals thereon would be deemed received by the USP employee-beneficiary as grantor-owner and exempted from U.S. tax, although subject to other limits such as the contribution limit found in section 415.

2. VEC Classification and Reporting: The RRSP Path

The Super is not the first pension plan to have been initially classified as a foreign nonqualified trust under section 402(b) in the absence of definitive IRS guidance. The IRS addressed the same issue with the Canadian registered retirement savings plan (RRSP), which it initially determined was equivalent to a U.S. IRA that did not meet the strict qualifications of section 408(a).[289] Indeed, the IRS views the beneficiary of a Canadian retirement plan as subject to U.S. tax on accrued yet undistributed income in the plan unless the plan constitutes an employees' trust under section 402(b) and the individual is not a highly compensated employee under section 402(b)(4)(A).[290] As a consequence, U.S. residents with contributions to, distributions from, and ownership of a Canadian trust for which an election to defer U.S. tax on accrued income under Article XVIII(7) is available would be obligated to file Form 3520 and Form 3520-A returns under section 6048.[291]

Admittedly, RRSPs do not constitute a social security program in Canada and in fact are not covered by the Canada-U.S. SSTA.[292] Despite that distinction, USP employee-beneficiaries of Canadian RRSPs and registered retirement income funds (RRIFs) have been exempted from foreign employee trust reporting requirements, while USP employee-beneficiaries of the Super do not have such clear guidance.

In Rev. Proc. 89-45,[293] the IRS described the RRSP as an IRA that meets the qualification requirements under section 408(a), with the result that earnings accrued in the plan were currently includable in the gross income of the beneficiary for U.S. tax purposes (while Canada deferred taxes on earnings until actual distribution).[294] Further, distributions received from an RRSP were also includable in gross income of the beneficiary under section 72, concurrent with Canadian taxation of the same amounts on distribution. In 2002 the IRS issued Rev. Proc. 2002-23,[295] which allowed U.S. and Canadian beneficiaries of RRSPs and RRIFs to elect to defer U.S. taxation on income accrued[296] in the RRSP until actual distribution is received. Shortly thereafter, the IRS announced a new simplified reporting regime pending design of a new form that would be more appropriate for reporting RRSP and RRIF interests.[297] That new reporting regime was in lieu of filing obligations under section 6048 (forms 3520 and 3520-A) that would otherwise apply.[298]

U.S. or Canadian beneficiaries of RRSPs or RRIFs making an election under Article XXIV(7) to defer taxation on accrued income in the RRSP or RRIF until actual distribution were not required to provide as much detailed information. According to Notice 2003-75, the new simplified reporting regime was instituted under the authority of section 6001 for tax compliance purposes and, consequently, no further reporting obligations under section 6048(d)(4) were required for RRSPs or RRIFs with beneficiaries and annuitants subject to the new simplified reporting regime.[299] No associated penalties under section 6677 were to apply to RRSPs and RRIFs, although a beneficiary or annuitant may have been subject to other penalties.[300]

Rev. Proc. 2014-55[301] introduced the most recent changes to the RRSP cross-border taxation regime by replacing all then-existing procedures that a beneficiary of a Canadian retirement plan must follow to make an election under treaty Article XVIII(7) with just two different procedures. Under the first method, an eligible

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[289] *See* Rev. Proc. 89-45, 1989-2 C.B. 596, *superseded by* Rev. Proc. 2002-23, 2002-1 C.B. 744. Rev. Proc. 89-45 provided guidance for applying former Article XXIX(5) of the Canada-U.S. treaty.

[290] Canada-U.S. treaty, Article XVIII (8). *See also* Rev. Proc. 2014-55, 2014-44 IRB 753, at section 2.01.

[291] *See* Rev. Proc. 2014-55 at section 2.04.

[292] Signed March 11, 1981.

[293] 1989-2 C.B. 596, *superseded by* Rev. Proc. 2002-23. Rev. Proc. 89-45 provided guidance for applying former Article XXIX(5) of Canada-U.S. treaty.

[294] Rev. Proc. 89-45 at section 2. Rev. Proc. 89-45 provided U.S. citizen beneficiaries of an RRSP an election to defer U.S. income taxes on the current-year undistributed earnings of the RRSP for a year if the contributions were made during the periods of Canadian residency.

[295] *See* Rev. Proc. 2002-23, providing guidance for applying new Article XVIII (7) of the Canada-U.S. treaty.

[296] Only income accrued in the RRSP was subject to deferral, not the RRSP contributions in all cases.

[297] *See* Notice 2003-75, 2003-2 C.B. 1204, *superseded by* Rev. Proc. 2014-55.

[298] We note, without confirmation or affirmation from the IRS, that the reporting obligations for Canadian RRSPs may have been excepted from the reporting obligations of foreign trusts because Article XVIII(7) and (8) of the Canada-U.S. treaty exempts contributions and earnings from taxation in the United States. If so, exemption from taxation under the appropriate income tax convention could be a condition precedent to the IRS's willingness to exempt USP employee-beneficiaries from reporting similar pensions from reporting as foreign trusts.

[299] *See* Notice 2003-75, section 3.

[300] *Id.*

[301] Rev. Proc. 2014-55, section 4.

individual[302] would elect to apply Article XVIII(7) by reporting on his Form 1040 all income recognized from the plan on receipt of distributions.[303] Under the second method, taxpayers who have previously reported all the undistributed accrued income earned in a Canadian retirement plan on their previously filed Form 1040 could make an election under Article XVIII(7) by requesting the commissioner's consent to apply Article XVIII(7).[304] Rev. Proc. 2014-55 provides that any election made thereunder is made plan by plan, regardless of whether the beneficiary was a resident of Canada when contributions were made to the plan.

Lastly, Rev. Proc. 2014-55 eliminated any further requirements for beneficiaries and annuitants of a Canadian retirement plan to report contributions to, distributions from, and ownership of Canadian retirement plans under the simplified reporting regime of Notice 2003-75 (obsoleting Form 8891) or under reporting obligations imposed by section 6048 (Form 3520). It did not, however, affect any reporting obligations for Form 8938 under section 6038D or FinCEN Form 114 imposed by 31 U.S.C. section 5314.[305]

3. Super Reporting Under Section 6048

Section 6048 imposes various reporting obligations on foreign trusts and persons making transfers to or receiving distributions from foreign trusts. A USP employee-beneficiary who is treated as an owner of any portion of a foreign trust is required to provide information regarding the trust and ensure that the trust complies with its reporting obligations.[306]

In light of the above technical concerns about the classification of the entire Super (both SG contribution and VEC portions) as a foreign trust under section 7701(a)(31) or as a funded and secured foreign pension plan under section 402(b) with an employee-grantor trust under reg. section 1.402(b)-1(b)(6), we propose that USP employee-beneficiaries of a Super be held to the same reporting obligations as beneficiaries of other foreign trusts. To do so would subject the USP employee-beneficiary, who is presumably a grantor and beneficiary of a Super, to information reporting requirements and penalties for the Super under section 6048, and, as a corollary, potentially annual PFIC reporting requirements[307] under section 1298, which may cause the taxpayer to incur significant tax compliance costs.[308]

Treasury regulations[309] under section 6048 require both grantors of foreign trusts and beneficiaries of foreign grantor trusts to file Form 3520 (for an ordinary transfer to the trust) and Form 3520-A (foreign grantors) to report their activities and interest. The regulations cover a range of activities that are likely to complicate actions conducted by or for the Super, and they will therefore cause it to file a U.S. tax form. Foreign trusts that constitute section 402(b) nonqualified deferred compensation trusts are exempted from that tax filing requirement under section 6048(3)(B)(ii) and its regulations. Those provisions state that contributions made to a nonqualified foreign trust under a plan that provides for pensions, profit-sharing, stock bonuses, sickness, accidents, unemployment welfare, and similar benefits or a combination of those contributions are not required to be reported under section 6048. Consequently, there is no affirmative obligation to file Form 3520 or Form 3520-A.

Our proposal bifurcates tax classification of the Super as a special hybrid trust entity under Australian law that comprises two independent foreign trusts: (1) the SG trust with the Australian commonwealth as grantor and owner, and trust assets composed entirely of SG contributions, accruals, and distributions equivalent to social security taxes and income that comprise social security benefits; and (2) a foreign private IRA with the USP employee-beneficiary as the grantor-owner that consists of VECs, accruals, and distributions that would be subject to special administrative reporting procedures similar to the administrative relief extended

[302] *See id.*, providing examples of what constitutes an eligible individual as a beneficiary of a Canadian retirement plan — that is, at any time he is or was a U.S. citizen or resident, has satisfied his U.S. federal income tax return filing obligations, has not reported his accrued earnings in the Canadian plan as gross income for U.S. tax purposes, and has reported all distributions received from the Canadian plan as if he had made an election under Article XVIII(7) to defer tax on accrued income in the plan until distribution.

[303] *Id.* at section 4.02. Individuals who did not make the election under Article XVIII (7) would be treated as having made it in the first year in which they would have been entitled to make the election. An election is effective for all years until a final distribution is made from the Canadian plan.

[304] *Id.* at section 4.04.

[305] *Id.* at section 5.

[306] JCT, ''General Explanation of Tax Legislation Enacted in the 111th Congress,'' JCS-2-11, at 242 (Mar. 2011).

[307] *See* H.R. Rep. No. 104-737, at 330-338 (1996); and T.D. 9650 (proposed and temporary regulations issued Dec. 31, 2013).

[308] Some U.S. expatriates in Australia have commiserated at the expensive tax compliance costs for preparing and filing Form 8621 for each foreign mutual fund held in the Super. One U.S. expatriate noted that he ended up filing 300 Forms 8621 in one year alone. If the U.S. person were to make a qualified electing fund election to report his share of the ordinary earnings or capital gains of the PFIC, perhaps to be eligible for preferential capital gains rates, it is unclear whether the necessary information would be readily available. Most commercially available foreign mutual fund investments do not qualify to allow the owner to make a QEF election because the information requirements of section 1295(a)(2)(B) cannot be satisfied. Hence, the grantor trust classification of the Super will likely lead to egregious overtaxation and burdensome and expensive tax reporting for no good policy reason.

[309] *See* reg. section 404.6048-1(a)(1); and reg. section 16.3-1(c). *See also* Notice 97-34, 1997-1 C.B. 422.

by the IRS to Canadian RRSPs. Absent that administrative relief, it would seem that the foreign private IRA would still be exempt from filing forms 3520 and 3520-A if it qualifies as a section 402(b) nonqualified trust as provided under section 6048(3)(B)(ii) and reg. section 16.3-1.

Rules that apply to Supers are needed to clarify that USP employee-beneficiaries of a Super are also not subject to section 6048 reporting requirements on income, gains, and earnings from the Super. To fail to do so would cause U.S. expatriates with Supers in Australia further aggravation arising from the requirement that they file their U.S. income returns consistently with the information received from the Super under section 6048.[310]

We recommend that regulations under section 6048 be amended to clarify that Super arrangements and other similar arrangements that are subject to an SSTA be excluded from reporting on forms 3520 and 3520-A.

G. Exclusion From FBAR

There is also confusion whether Supers constitute foreign financial accounts subject to FBAR reporting requirements.[311] There is no explicit exemption in the FBAR regulations that excludes Supers from reporting on the FBAR. We believe the IRS should amend the regulations to provide for an exemption for Supers from FBAR reporting, or, at the very least, clarify that the Super and similar arrangements subject to an SSTA do not constitute foreign financial accounts for FBAR purposes. Neither the preambles nor the text to 31 CFR section 1010.350 confirm an exemption for interests in a social security-type program such as the Super.

Despite the foregoing, the preamble[312] to section section 6038D and the IRS website[313] both exclude from the definition of foreign financial asset reporting interests in social security, social insurance, or similar programs of a foreign government. It baffles us that the Super would be treated as a foreign financial account under FBAR when it is clearly exempted as a nonfinancial foreign asset for purposes of the U.S. Foreign Account Tax Compliance Act.

In light of the foregoing, we request that Treasury amend the regulations under 31 CFR section 1010.350(c)(4) to clarify that Supers and similar arrangements subject to an SSTA are excluded from reporting on FinCEN Form 114.

H. Reporting for Social Insurance Programs

We propose to bifurcate the U.S. tax treatment of the Super into two separate trusts; namely, (1) the SG trust consisting of SG contributions to the Super as social security taxes and income accruals and distributions derived thereafter as social security benefits paid by the Australian government to a USP employee-beneficiary of a Super; and (2) a VEC trust, which would include all other contributions. Our proposal to bifurcate the classification of the Super into an exempt portion and a nonexempt portion would not create new reporting obligations or complicate existing ones.

Treasury and the IRS have already exercised their authority under section 6001 to exempt interests in Social Security, social insurance, and similar programs from affirmative tax reporting obligations in several different provisions of the code. It is within their authority to tailor new administrative procedures to remedy the U.S. income taxation and tax compliance travails faced by U.S. beneficiaries of Australian superannuation funds. We believe that Treasury and the IRS can accomplish that under the authority granted by section 6001. The following are examples of areas in which they have created similar relief.

1. Section 6038D Preamble (Form 8938)

The preamble[314] to the temporary regulations under section 6038D and instructions to Form 8938 exclude from the definition of specified foreign financial asset an ''interest in a social security, social insurance or other similar program of a foreign government,''[315] which exempts those interests from reporting. As mentioned, a chart on the IRS website[316] comparing reporting requirements between Form 8938 and the FBAR also listed those same programs as excluded from the definition of foreign financial assets under reg. section 1.6038D-3(b)(1). Consequently, there is no requirement to report the SG trust component of the Super on Form 8938 because it would not constitute a foreign financial asset under section 6038D.

Similarly, the VEC trust component of the Super should be exempted from the definition of foreign financial asset if it constitutes an indivisible component of the Super. There is a predisposition to treat the VEC trust component (as well as the SG trust component) as a foreign retirement or pension account under section 402(b), which would cause the USP employee-beneficiary to report her interest on Form 8938 as a foreign financial account under section 6038D.[317]

[310]*See* H.R. Rep. No. 105-220, at 551 (1997).

[311]*See generally* 31 CFR section 1010.350.

[312]T.D. 9706.

[313]*See* https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

[314]T.D. 9567.

[315]*Id.* at Part D.

[316]*See* https://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

[317]*See* T.D. 9706; and reg. section 1.6038D-3(b)(1). The preamble to the final regulations under section 6038D modified the definition of a financial account under the 2011 temporary regulations (which adopted the definition under chapter 4 of financial account with an exception for some retirement and pension

(Footnote continued on next page.)

2. Reg. Section 301.6114-1 (Form 8833)

Under section 6114(a), a taxpayer who asserts that a treaty overrules or modifies a provision of the code is required to disclose that position to the IRS by filing Form 8833.[318] The IRS has waived[319] that requirement for return positions that an SSTA or diplomatic or consular agreement reduces or modifies the taxation of income derived by the taxpayer.[320] Consequently, USP employee-beneficiaries of a Super should not be required to disclose the SSTA on Form 8833 to claim their totalization benefits under the SSTA. In the same vein, article 18(2) of the Australia-U.S. tax treaty exempts the SG trust from current U.S. income taxation.

3. Section 409A

In June 2009 the U.S. Advisory Committee on Tax Exempt and Government Entities released a report on international pensions that identified the U.S. taxation of foreign pension plans as an area that required clarifying guidance from the IRS.[321] Specifically, it concluded that U.S. persons who participated in funded non-U.S. retirement plans were subject to U.S. income taxation under section 402(b)(4) because the foreign plan could not constitute an exempt plan under section 401(a).[322] The committee recommended that clarifying guidance be issued to confirm that section 402(b) ''was never intended to apply to foreign plans that were established as foreign nonqualified plans.''[323] As a result, U.S. participants are subject to less favorable U.S. tax rules under section 402(b)(4), which taxes the employee on the employer's contributions to the trust during the applicable tax year for which the trust is not exempt, if the employee's interest in the trust is vested.[324]

The need to issue clarifying guidance to exempt funded foreign pension plans from inadvertent income taxation under section 402(b) is more acute with the Super because it presents a tax issue with no precedent in the IRC: Cash basis U.S. taxpayers are taxed on foreign employer contributions, which constitute Australian social security benefits that have not yet been paid or made available to them by operation of Australian law. If no clarifying guidance is provided, that fact alone arguably raises constitutional problems[325] and issues with overall tax fairness. That same problem arises regarding the section 402(b) taxation of employee contributions to the Super, which have also yet to be paid or distributed to the U.S. taxpayer.

There is precedent for the IRS and Treasury to exclude foreign retirement arrangements from the application of U.S. tax law. That happened most recently in 2007, when final regulations were issued under section 409A.[326] Those regulations contained a provision that exempted foreign nonqualified pensions from U.S. income taxation as deferred compensation under section 409A if specified conditions were met. The foreign pension plan must have an applicable tax treaty that excludes contributions made to a foreign nonqualified deferred compensation plan from U.S. federal income taxes;[327] be a broad-based foreign retirement plan under section 409A;[328] or be subject to a totalization agreement.[329] The IRS said:

> Commentators also requested that the amounts contributed or benefits paid under a foreign social security system that is the subject of a totalization agreement be exempted from coverage under section 409A. . . . The Treasury Department and

accounts) to include retirement and pension accounts as a financial account for purposes of section 6038D to require consistent reporting.

[318] Form 8833, ''Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b).''

[319] *See* section 6114(b); and reg. section 301.6114-1(d).

[320] Reg. section 301.6114-1(c)(vii).

[321] *See* Advisory Committee on Tax Exempt and Government Entities, ''International Pension Issues in a Global Economy: A Survey and Assessment of IRS Role in Breaking Down the Barriers'' (June 10, 2009).

[322] According to the committee, a foreign funded pension would fail coverage testing required under section 501(a) because it would not meet section 401(a)(26) or 410(b); the plan would fail because of the requirement to ignore coverage of nonresident aliens participating in the plan with U.S. expatriates. *Id.*

[323] *Id.* at 44. *See also* comments of the American Bar Association Section of Taxation (Feb. 22, 2006) regarding nonqualified deferred compensation, focusing on foreign plan aspects under the proposed section 409A regulations (stating that foreign funded retirement plans such as U.K. and Canada registered retirement plans and like arrangements, which are already taxable under section 402(b), should be excepted from section 409A because foreign funded retirement plans ''are not the target of section 409A'').

[324] Advisory Committee on Tax Exempt and Government Entities, *supra* note 321, at 43-44.

[325] The constitutionality issue raised by Richard Skillman in his comments to Treasury regarding prop. reg. section 1.4090-4(g) was limited to the issue of income subject to income tax under the 16th Amendment. *See* Skillman comments (Aug. 6, 2010). Skillman pointed out that income must represent an ''accession to wealth'' under *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), for that income to be subject to income tax under the 16th Amendment. The constitutionality issues are not limited to whether social security benefits and employee contributions to the Super, which are mere foreseeable and anticipated accessions to wealth, should constitute income subject to income tax even though those amounts remain subject to contingencies that may result in nonpayment. *See Murphy v. IRS*, 493 F.3d 170 (D.C. Cir. 2007). Rather, the constitutionality issues also extend to questions with the Australia-U.S. treaty, which reserves taxation of Australian social security benefits paid to a U.S. resident to the Australian government (article 18(2)), and the Australia-U.S. totalization agreement, which prevents taxation of wages subject to Australian social security taxes from concurrent taxation by the United States.

[326] *See* T.D. 9321.

[327] *See* preamble to T.D. 9321, section H(1); and reg. section 1.409A-1(a)(3)(i).

[328] *See* preamble to T.D. 9321, section H(2); and reg. section 1.409(A)-1(a)(3)(VI).

[329] *See* reg. section 1.409A-1(a)(3)(v).

the IRS believe that section 409A was not intended to apply to benefits to which the service provider is entitled under foreign jurisdiction social security system. Accordingly, these types of plans have been excluded from the definition of nonqualified deferred compensation plan for purposes of Section 409A. Similarly, for jurisdictions not covered by a totalization agreement, these regulations provide that amounts deferred under a government mandated social security system are not subject to Section 409A.[330] ◆

[330]REG-158080-04, 70 F.R. 57930, at 57939 (Oct. 4, 2005).