

# Proposal for the Outdated Australia-US Tax Treaty

Submission to Treasury by Peter Clarebrough, 30 October 2021

I am an Australian citizen and moved to the US in 2009 after being randomly drawn in the US Green Card Lottery and was successful in obtaining a Green Card Visa to reside in the US. Later, I became a dual citizen when I was granted US citizenship in 2014. When I first moved to the US I had no idea of the tax implications that I was going to face and have paid in terms of financially which I will explain below. The two areas that have impacted me the most were my Australian Superannuation account and the sale of my home in Melbourne.

## Australian Superannuation

After moving to the US, I believed that my superannuation would just keep growing with the annual returns compounding and by the time I retired, funds could be drawn down annually and transferred to the US. I have not made any contributions to the fund since leaving Australia in 2009.

In the US, my annual tax return is completed by a reputable tax accountant, H&R Block. The American tax system is significantly more complex from what I had experience with preparing my taxes in Australia. It was due to this complexity that I wanted to ensure that I was following US Tax laws to the letter. Each year when I met with the H&R Block Accountant I was advised that I did not need to report my Australian Superannuation account as it was a “retirement account” and only needed to declare the withdrawals when I eventually retired as these would be taxed at my personal tax rate by both the Federal and state (California) government. I had been given this same advise by H&R Block each year for the last 11 years. Earlier this year I found out that this advice was totally incorrect which I discovered after wanting to learn more about the tax implications on my superannuation in preparation for retirement. I did a web search which gave me great concern, so much so I consulted with a Tax Lawyer to give me advice on what needed to be done to get into compliance with the US Internal Revenue Service (IRS).

Firstly, I was told that I should have been reporting the Australian Superannuation account and balance details each year to the IRS by completing “**Form 8938 Statement of Specified Foreign Financial Assets**”, in addition the “**Report of Foreign Bank and Financial Accounts (FBAR form)**” despite the later form having conflicting instructions which states “...*you don't need to report foreign financial accounts that are: ...Held in a retirement plan of which you're a participant or beneficiary*”. One of the largest reputable accounting firms in the US got this wrong for the last 11 years. The IRS has a specific definition of “retirement plan” and unless you knew to drill down into the detail to ascertain the definition you wouldn't know that the IRS considers a “retirement plan” as “*A participant in or beneficiary of a retirement plan described in Internal Revenue Code § 401(a), 403(a), or 403(b) is not required to report a foreign financial account held by or on behalf of the retirement plan.*” In other words, unless the retirement plan originated in the US you **WOULD** have to report it. Why is this important? Failure to report foreign accounts such as my Australia Superannuation comes with heavy financial penalties by the IRS. In order to correct my mistake I had to complete **Form 14654 – Certification by U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedures**”. As my Australian Super had grown over time I ended up having to pay a **Miscellaneous Offshore Penalty** of US \$12,650 which was **5%** of my Superannuation balance.

With the confusing and unclear guidelines by the IRS, and H&R Block failing to provide the correct advice, I would expect many Australian's residing in the US have not been reporting their Superannuation details to the IRS and therefore not been in compliance. Those that have not been reporting will incur significant financial losses when they eventually start withdrawing funds at retirement. The 5% penalty is calculated on the highest collective balances of all foreign accounts, which includes the superannuation account, in a year, over the last seven years. The year which has the highest balance is used too calculate the 5% penalty. Imagine the sizable retirement accounts that would take a hit by the IRS for failing to report due to the confusion of no clear guidelines. This does not include all the additional costs incurred to resubmit the last seven years' US tax returns.

Reporting of Australian Superannuation to the IRS is not specifically mentioned ANYWHERE on the IRS website. There are no clear guidelines and US Accountants, in general, are not aware of what needs to be done. This has caused considerable stress, worry, and anxiety that my retirement nest egg could have been eroded away with penalties, interest, and back taxes imposed by the IRS. Despite the large penalty incurred, I still live with uncertainty in terms of how my superannuation will be treated by the IRS in the future, and would like to have some peace of mind in my late years that I can count on this account towards my retirement.

There remains significant confusion by Australians living in the US or Americans residing in Australia as to how Superannuation gains should or should not be taxed by the IRS. I have yet to get a clear answer despite in-depth research, consultation with H&R Block, and discussing with a specialist tax lawyer. I have read on the web that if you are deemed a "High Earner" by the IRS then these gains are taxable in your annual US Tax Return. This would result, in effect, **quadruple taxation**:

- Already paid the ATO 15% on the original super contributions when I was working in Australia
- IRS would then charge taxes on the superannuation account annual gains (My US Federal tax rate of 24%),
- When I retire and start to withdraw from the Super fund I will be subject to taxes on the total withdrawn amount I.e. both contributions and gains:
  - Federal taxes (Current tax rate of 24%); and
  - State Government (Tax rate of 9.3%)

How is this fair when you are trying to save for your retirement? Why should I or other Australians be so heavily penalized for having a government mandated Superannuation account that I have not contributed to since I ceased working in Australia and moved to the US?

### **Recommendation**

1. That all annual investment gains in the Australian Superannuation account are exempt from annual US taxes.
2. That Australian Superannuation Accounts are treated as a form of Social Security and payments to US or Australian residents from their super is not subject to US taxation. This should be subject to reaching full retirement age I.e. 59.5, with a 10% penalty tax on top of current personal income tax rates for early withdrawal before reaching full retirement age.

3. For the Australia-US Tax Treaty and the IRS to recognize Australian Superannuation as a legitimate “Retirement Account”. In addition, that it should be excluded from annual reporting as a foreign account I.e. Form 8938 and FBAR form.

### **Capital Gains Tax imposed by the IRS on Property**

After moving to the US from Australia in 2009 I stayed in my partner’s home and rented my home out in Melbourne for a year to cover the cost of the mortgage payments. I wasn’t sure what to do with the property and wanted to wait before selling to ensure everything was working out with the move to the US. I did sell it after renting it for two years. When I completed my US Tax return after the sale, I discovered that my home in Australia was being classified as an “investment property” by the IRS and despite having no financial interest in my partner’s property. The property had increased in value since I purchased it, and I incurred a 15% Capital Gains taxes of approximately US \$24,000. The ATO does not charge Australians Capital Gains tax on their principal residence, but the US does.

I discovered soon after that Australian’s moving to the US must sell their property within 6 months to avoid Capital Gains tax being applicable by the IRS. Like the reporting of superannuation, there was little tax guidance for immigrants. I would have avoided this significant cost if I had realized that I had to sell my home within 6 months.

### **Recommendation**

1. That the Australian-US Tax Treaty gives Australian immigrants to the US two years to dispose of their principle residential property to be exempt from US Capital Gains Tax.

### **In Summary**

I have considered the possibility of returning home to Australia as I get closer to retirement age. What hinders me doing so are the tax implications. Although I stopped contributing to my Australian Superannuation when I left Australia in 2009, I started contributing to the US equivalent, a 401K Retirement account, after I moved and have paid into this account for the last 11 years. If I was to return to Australia, both the ATO and the IRS would tax my 401K withdrawals. In fact the ATO and the US would tax all of my income obtained from investments in both the US and Australia if I did move back to Melbourne. I understand that there is offsetting that happens between taxes paid in Australia against taxes paid to the IRS. But still, returning home would cause a higher significant tax burden on retirement savings. As I mentioned previously, I am still subject to double taxation for drawing down my Australian Superannuation while residing in the US, but at least Australia does not tax on world wide income like the US does.

There needs to be a more balanced approach that doesn’t disadvantage Australians or Americans that reside in either country. This also includes individual reporting requirements to the tax authorities which result in high accounting and legal costs due to the complexity and specialized nature of the current Australia-US Tax Treaty. Retirement savings should not be double or **quadruple** taxed.

Give Australians residing in the US and Americans residing in Australia some peace of mind that they are being treated fairly by having a balanced Australia-US Tax Treaty that doesn’t financially disadvantage them for taking the bold step to immigrate in the first place. Thank you for reading my submission and giving this consideration.