

# Residency and bringing superannuation to Australia

by Chris Wallis, Victorian Bar & Director of Tax Matrix Pty Ltd

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## APPENDIX G

### Submission to the Select Senate Committee on Superannuation, with respect to the Parliamentary inquiry on transfers from overseas superannuation funds

The submission was made by Mr Vladimir Menkov <sup>1</sup>

#### FOREIGN SUPERANNUATION FUNDS: NORTH AMERICAN EXPERIENCE

Honorable Members of the Committee:

A non-citizen has, of course, no right to comment on proposed changes to Australian laws. Nonetheless I felt that it may be useful to bring some North American perspective to the current Parliamentary inquiry on transfers from overseas superannuation funds.

There are thousands of people in Canada and the USA, often in the middle of their careers, and already having accumulated substantial retirement savings, considering migrating to Australia permanently or temporarily (but for a long enough term to become residents for tax purposes). There are perhaps even more Australian citizens working in North America and contributing to US and Canadian retirement plans, and considering eventually coming back to Australia. For example, according to the US INS statistics [1], just in one fiscal year (1999), more than 14,000 Australian citizens entered the USA just on temporary employment or self-employment visas (H1, H2, L1, and E1); this implies that the total professional population of Australians in the USA, on temporary or permanent visas, is tens of thousand of people; most of them have US retirement accounts.

#### BACKGROUND

What kind of superannuation plans do people working in North America contribute to? How could a wise government treat their retirement savings upon moving to Australia, so as not to discourage people from such a move in the first place?

The most common superannuation scheme (or retirement savings plan, as we say in these parts) in the USA is an IRA (Individual Retirement Account) account; it is available to everybody with an earned income, or his or her spouse, and involves no employment sponsorship. Substantially similar employment-sponsored accounts, under Sections 401(k) and 403(b) of the US Internal Revenue Code, are offered by some employers to their employees; upon the termination of employment, the employee typically transfers his funds from such a plan to an IRA. In Canada, RRSP (Registered Retirement Savings Plan) plans are available to everybody with an earned income. All these plans work in a similar way: they defer taxation of both the principal and the interest until the time the account holder withdraws the money in retirement. That is, the worker's contribution to the plan is deductible from his taxable income in the year when it was made; no tax is payable by the plan on its income as long as the funds are not withdrawn; and when the retiree finally withdraws some funds from his retirement account, the amount withdrawn is included in his taxable income. The USA also imposes an additional 10% "early withdrawal" penalty unless the withdrawal made when the account holder has reached the age of 60, or is disabled; Canada currently has no such provision. Although contributions are not compulsory, the advantages of such plans make them immensely popular in both USA and Canada, and millions of working people expect to rely on them as the main source of their livelihood in their future retirement.

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### CANADIAN APPROACH TO TRANS-BORDER MIGRANTS' SAVINGS

Canada, like Australia, is a comparatively small country; thus, the amount of cross-border migration between Canada and the USA is quite significant, in proportion to the size of Canada's workforce. If Canada had made it necessary, by prohibitive taxation, for US residents to collapse their IRA plans when moving to Canada, it would be a great disservice to many of its productive citizens and residents, and well could actually be counter-productive for tax collection, by making people stay south of the border who would otherwise immigrate to Canada, or move back to Canada. Understanding this, Canadian government adopted in 1990 the concept of a "foreign retirement arrangement" [2], which effectively synchronize Canadian and foreign taxation of retirement arrangements created by a currently-Canadian resident back when he was resident in a foreign country. Under Canadian rules, the income produced by investments held by a Canadian resident in a "foreign retirement arrangement" are not taxed while the funds are not taken out of the plan; and the withdrawals made from the plan are taxable if and only if they are taxable in the foreign country where the plan is established (or would be taxable, if the taxpayer were resident there). These rules also protect foreign retirement arrangements from the application of so-called foreign passive income rules (which are similar to the Australian FIF rules). The rules provide for a tax-free rollover from a foreign retirement arrangement into a Canadian plan at any time (that is, a distribution from a US IRA can be invested into a Canadian RRSP, and no taxable income will be realized until a distribution from the RRSP is eventually made), but don't mandate it.

A "foreign retirement arrangement" is any plan prescribed by regulation to be such; although, unfortunately, so far only the US IRA plans are so prescribed.

Under a tax treaty [3], the USA also offers reciprocal tax-deferment treatment to a Canadian RRSP account held by a currently-US resident.

### SUGGESTIONS

- (1) The honoring of each other's tax deferred plans works well for Canada (and the USA, although they probably don't care much; for them it is a drop in the bucket). May I humbly suggest that the honorable committee consider whether it won't be to the Commonwealth's advantage to follow this practice and allow people who have contributed to a retirement plan while residing and working in a foreign country to simply keep their money in such a plan tax-deferred for as long as they want? When a person makes a withdrawal, the amount withdrawn can either be included into his taxable income, unless it is re-invested into an Australian superannuation plan. While foregoing some current revenue, such policy may eventually result into more better-off foreign workers and expatriate Australians coming to the country, and eventually paying more in tax and using less in social benefits.

Naturally, the government may only include certain foreign plans into the list of such prescribed foreign retirement arrangements; but whatever the selection criteria may be like, the Canadian RRSP and USA IRA accounts should likely be included, since both countries are quite strict with preventing any abuse of such plans, and, moreover, impose fairly tight limits on how much funds one can contribute per year.

- (2) While allowing a tax-free transfer from a foreign retirement arrangement into an Australian super fund is a good thing, simply allowing such a transfer, especially only within a short time, may not always be a good solution for a migrant or a returnee, for a number of reasons. First, the tax law of the source country may often impose an early withdrawal penalty, as it is the case with the US IRAs. Second, even when there is no penalty, IRA or RRSP withdrawals are usually taxable income under Canadian or USA law, even to a non-resident. The taxpayer, most likely, won't be able to take a foreign tax credit in Australia for this tax, since there is no corresponding income to show; as a result, double taxation will take place when the retiree later on makes a (taxable) withdrawal from the Australian super account. Third, by collapsing one's IRA or RRSP plan the person will forever forgo

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the ability to enjoy tax deferral of these funds under USA or Canadian law should he find himself again working in North America for a number of years.

Therefore, I believe that while a tax-free rollover from a foreign retirement account into an Australian super account should be allowed, it should not be mandated or be required to be made within a tight time frame. For example, the holder of a US IRA account, to avoid the penalty, may want to delay the transfer until he is 59; or to choose a withdrawal in substantially equal installments over his life expectancy; or, at least, he may choose to withdraw funds in annual installments not to exceed the American standard exemption (around US\$2500, currently), in order to pay only the penalty and no regular US income tax. This may delay "making the funds work in the Australian economy", but will eventually bring more funds into Australia, since it minimizes foreign tax paid.

- (2) Australia frequently negotiates updates to tax treaties with foreign countries. I believe that it is to Australia's advantage to insist, during such negotiations, that a foreign country reciprocally honors tax-deferred status of an Australian superannuation plan established by person resident in Australia, who later becomes resident in a foreign country. It may not be that difficult to convince Canada to add Australian regulated super arrangements to the list of "foreign retirement arrangements" honored by Canada. The USA may be less concerned with such a small issue, but since Canadians managed to convince them to offer such a status to Canadian retirements plans, surely Australia can too.
- (3) To encourage transfers from foreign funds, a possible topic for treaty negotiations may be getting foreign countries to reduce the amount of income tax and penalties payable when funds are taken from a retirement account in the foreign country in order to roll them over into an Australian superannuation account. Again, such treatment may be made reciprocal.
- (4) Should a person have to pay income tax or 10% penalty to a foreign country in order to withdraw his retirement funds for rolling them over into an Australian superannuation scheme, a consideration should be made for allowing him to, eventually, take a foreign tax credit for this tax against Australian tax, even if there is no Australian tax liability involved in the year of the transfer. Perhaps some kind of carry-forward scheme can be thought of.

Yours very sincerely,

Vladimir Menkov

### References:

[1] "The INS Statistical Yearbook" for Fiscal Year 1999; Tables 36, 37.

Available at <http://www.ins.usdoj.gov/text/aboutins/statistics/99yrtemp.htm>

[2] CCH Canadian Ltd., "Preparing Your Income Tax Returns".

North York, ON, 1999. ISBN 1-55141-406-6.

[3] Canada-US Income Tax Treaty. Article XXIX.

Available e.g. at <http://www.intltaxlaw.com/treaties/canada/frontpage.htm>