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30 April 2012

Hon. Douglas H. Shulman
Commissioner
Internal Revenue Service

Mr Stephen E. Shay
Deputy Assistant Secretary for International Tax Affairs
U.S. Treasury Department

Mr Steven A. Musher
Associate Chief Counsel (International)
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Mr Michael Plowgian
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CC:PA:LPD:PR (REG-121647-10)
Room 5205,
Internal Revenue Service
PO Box 7604
Ben Franklin Station, Washington, D.C. 20044

** Can be sent electronically via via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-121647-10) **

Dear Mr Shulman, Mr Musher, Mr Sweeney, Mr Shay and Mr Plowgian,

## Re: Foreign Account Tax Compliance Act (FATCA)
## IRS Notice 2012-15 - Proposed Regulations for FATCA Implementation

The Association of Superannuation Funds of Australia (ASFA) is a non-profit national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members.

In Australia, the total estimated superannuation assets as at 30 June 2011 was $1.34 trillion. These assets are held by various superannuation entities including superannuation funds (otherwise

referred to as retirement funds), pooled superannuation trusts (PSTs), approved deposit funds (ADFs) and retirement savings accounts (RSAs).

ASFA members - which include corporate, public sector, industry and retail superannuation funds - account for more than 5.7 million member accounts and over 80% of superannuation savings in Australia. Our members also include providers of PSTs, ADFs and RSAs. Superannuation funds also invest in PSTs with around $86.8 billion of superannuation assets invested in such entities and accordingly they are an important part of the Australian superannuation system.

Following on from our discussions earlier this month, ASFA would like to provide the following comments in response to the request for comments in IRS Notice 2012-15 regarding the release of the FATCA proposed regulations by the U.S. Treasury and Internal Revenue Service (IRS) on 8 February 2012. This follows on from ASFA's previous submissions in relation to previous requests for comments in section II, sub section E of the Notice 2010-60.

## Submission

ASFA acknowledges the U.S. Treasury's and IRS's intention to deem certain foreign retirement funds compliant with the requirements of section 1471(b) and to exclude certain foreign retirement funds from the requirement to collect all of the FATCA information and documentation necessary to be passed on to some other entity in the relevant investment chain for their withholding and reporting purposes.

However, from an Australian perspective, ASFA believes that the proposed regulations still do not provide relief for Australian retirement funds or their membership from the FATCA provisions.

In consideration of the FATCA proposed guidance released by the U.S. Treasury and IRS, ASFA would like to comment on the following key issues from the Australian superannuation industry perspective:

I. Retirement fund deemed compliant status

II. Exempt beneficial owner deemed compliant status

III. The exclusion of certain retirement accounts from the definition of "financial account".

### Current application of the proposed FATCA regulations

We have identified a number of categories and conditions within those categories that could be satisfied for a foreign retirement fund to have deemed compliant status. A summary of those conditions and the likelihood of an Australian retirement fund satisfying those conditions are summarised in the table in Appendix A.

Under the current conditions in the proposed regulations, ASFA believes that it is very unlikely that any Australian retirement fund will have deemed compliant status under the FATCA provisions. ASFA's analysis of the application of the retirement funds deemed compliant categories to Australian superannuation entities is set out in the following table:

| Type of superannuation entity | Will an Australian superannuation entity satisfy the following deemed compliant categories? | | | |
|---|---|---|---|---|
| | Retirement fund | | Exempt beneficial owner | |
| | Retirement fund with 20+ members | Retirement fund with <20 members | Tax exempt treaty country retirement fund | Other retirement fund |
| **Complying fund – non SMSF** | × | Unlikely | × | × |
| **Complying fund - SMSF** | × | Potentially | × | × |
| **Non-complying super fund** | × | × | × | × |
| **Exempt public sector funds** | × | × | ? | × |
| **ADF** | × | × | × | × |
| **PST** | × | × | × | × |
| **Life company/ friendly society super policy/ virtual PST arrangements** | × | × | × | × |
| **RSAs** | × | × | × | × |

As Australian superannuation entities are regulated as superannuation entities (either as a superannuation fund, ADF or PST) and not as investment vehicles, the broader registered deemed compliant categories will not apply to Australian superannuation entities.

Nor will the qualified collective investment vehicle registered deemed compliant category apply to investment entities that are solely owned by Australian retirement funds or more broadly by Australian superannuation entities.

We note with some concern that the tests that need to be satisfied to be deemed compliant are very prescriptive. In addition to requiring the entity to be a retirement/pension fund, the proposed regulation limit/restrict many aspects of a retirement fund's operations including the type of contributions that can be accepted, the amount of contributions and the value of benefits that the fund can hold for its members. We would expect that the appropriateness of these types of operational issues should be determined by the relevant governmental authorities within the home country jurisdiction of the foreign retirement fund based on government policies and other relevant factors within that jurisdiction.

We are concerned that the prescriptive nature of the proposed tests could result in the U.S. potentially impinging on the sovereign rights of the foreign retirement fund's home country to determine the most appropriate retirement fund regime for their jurisdiction.

Based on the current proposed regulations, the FATCA provisions will generally apply to Australian retirement funds in the following manner:

1. Australian retirement funds will not be certified deemed compliant as they are unlikely to satisfy the retirement fund conditions required for deemed compliance purposes.

The main reason why Australian retirement funds will not satisfy the deemed compliant provisions is that most (if not all) Australian retirement funds do not restrict contributions to just employer, government or employee contributions and that contributions are not limited by reference to earned income.

The purpose of the Australian compulsory superannuation regime is to impose a minimum contribution amount (not a maximum limit) and the Australian superannuation regime has been built upon three pillars as described below where voluntary contributions from all sources (both employer and member) are actively encouraged.

2. As Australian retirement funds will not be deemed compliant, they will need to enter into an foreign financial institution (FFI) agreement with the U.S. IRS and they will need to comply with all of the conditions/requirements included in the FFI agreement.

3. To determine what member accounts Australian retirement funds will need to report to the U.S, Australian retirement funds will need to consider the financial account exceptions - the main exception being the retirement/pension account exception.

4. The retirement/pension account exception could apply provided the underlying accounts of the Australian retirement funds are subject to regulation on a "look-through" basis as it is the Australian retirement fund that is subject to regulation – not the member account.

   If this look-through approach is not adopted, no member account in an Australian retirement fund could satisfy this requirement - only retirement savings accounts (RSAs) could satisfy this exception.

   There are also a number of other conditions that must be satisfied for this exception to apply.

5. For each member account, the Australian retirement fund will need to determine:

   a. *that the account is tax-favoured* - Accounts in Australian retirement funds will pass this test

   And

   b. *that all contributions to the account are employer, government or employee contributions that are limited by reference to earned income under the local laws* – It is unlikely that this test will be satisfied given that accounts are generally not set up with such restrictions/limits on the types of contributions that can be accepted attached to them

   And

   c. *that annual contributions are limited to US$50,000 or less and limits/penalties apply for early access to benefits before reaching a specific age and to contributions exceeding US$50,000* – While penalties apply in Australia if benefits are taken before the member reaches his/her preservation age (which is generally between 55 and 60 years), the

Australian contribution rules, although restrictive, do not reflect the proposed US$50,000 limit.

Given the above tests, Australian retirement/pension accounts will be "financial accounts" for FATCA purposes which means Australian retirement funds will be required to do everything that their FFI agreements require them to do for the vast majority (if not all) of their member accounts.

**Therefore, while there are carve-outs for retirement funds and retirement accounts, Australian retirement funds will not benefit from those carve-outs.**

The key reasons why the FATCA carve-outs do not apply in the Australian context are the structure and operational framework of the Australian superannuation industry.

While the proposed retirement fund deemed compliant category represents a broadening of the previous proposed exemption for retirement funds, it is still unlikely that Australian retirement funds will satisfy the proposed tests. This is because the employer-sponsor test that was included in the original carve-out has been replaced with the pseudo-employment test as it requires:

1. The types of contributions to be received by a fund to be limited to employer, government and employee contributions; and

2. For those contributions to be limited by reference to the member's earned income.

In an Australian context, it is unlikely that any Australia retirement fund would satisfy this pseudo-employment test. Unlike most jurisdictions, the Australian retirement system has been built around three pillars being:

1 The age pension – which is basically a poverty alleviation function;

2 Compulsory contributions – which is primarily the superannuation guarantee (SG) system which sets a minimum base level of support by employers; and

3 Voluntary contributions – which includes both employer/employee/non-employee voluntary contributions and is actively encouraged by the Government.

As such, it is unlikely that any fund would limit the contributions that it receives to only employer, government and employee contributions as this would mean that the fund could not accept contributions for self-employed persons, substantially self-employed persons, unemployed persons, spouses and so on. The proposed pseudo-employment test is contrary to policies that Australian governments have implemented over many years to increase the level of retirement savings in Australia.

It is also unlikely that any fund limits the contributions it receives to just the Australian superannuation guarantee (SG) contributions. Australia's compulsory SG system imposes a base-minimum contribution rate on employers and not a maximum contribution limit as such. The third pillar of the Australian system relates to voluntary contributions from all sources (including employer voluntary contributions). In the Australian context, this third pillar is as important (if not more important) than the compulsory super (SG) pillar.

Therefore, it is very unlikely that any Australian retirement fund will satisfy the proposed retirement fund deemed compliant category. Similarly, Australian member accounts held by Australian retirement funds are unlikely to satisfy the proposed financial account exception for the same reasons.

## Proposed amendment

As indicated in our previous submissions, while there are many common superannuation/retirement fund features across various jurisdictions, there are also many differences and some jurisdictions are more mature than others. ASFA understands that the U.S. Treasury and the IRS are reluctant to provide exemptions on a country by country basis. As such, Treasury and the IRS are looking at a generic exemption which can be applied across all jurisdictions.

ASFA submits that an additional deemed compliant retirement fund category should be included in the retirement fund deemed compliant category which should also be reflected in the retirement fund exempt beneficial owner category and the financial account exception.

ASFA submits that the wording for the additional deemed compliant retirement fund category should be as follows:

*"(3) An FFI meets the requirements of this paragraph (f)(2)(ii)(A)(3) if—*

i. *The FFI is supervised by a relevant government authority in the country in which the FFI is established or in which it operates for the purpose of providing retirement or pension benefits*

ii. *The FFI is established or operates in a country with which the United States has an income tax treaty or an information exchange agreement; or has entered into an intergovernmental agreement with the United States in relation to the implementation of Chapter 4;*

iii. *Limits and/or penalties apply under the law of the jurisdiction in which the FFI is established or in which it operates to withdrawals made from the FFI (except for transfers to other funds that satisfy paragraph (f)(2)(ii) or exempt beneficial owner retirement funds under §1.1471-6(f) or accounts described in paragraph (b)(2)(i)(A)) before the beneficiary reaches the specified minimum retirement or preservation age (whichever is earlier) under the law of that jurisdiction or other circumstances as approved under the law of that jurisdiction;*

iv. *Limits and/or penalties apply under the law of the jurisdiction in which the FFI is established or in which it operates to contributions made to the FFI for a beneficiary which exceed the specified contributions limits under the law of that jurisdiction;*

v. *The FFI is required to report regularly (at least on an annual basis) to the relevant government authority under the law of the jurisdiction in which the FFI is established or in which it operates the member account and contributions data for each member, including any identifiers held by the FFI which are used to identify the individual for income tax purposes in the jurisdiction in which the FFI is established or in which it*

*operates;*

*vi. At least two of the following applies:*

*(a) The FFI is unable to accept personal contributions for a beneficiary under the law of the jurisdiction in which the FFI is established or in which it operates without the FFI having identifiers to identify the individual for income tax purposes in the jurisdiction in which the FFI is established or in which it operates;*

*(b) Contributions to the FFI that would otherwise be subject to tax under the laws of the jurisdiction where the FFI is established or operates are deductible or excluded from gross income of the beneficiary;*

*(c) The FFI is subject to tax-preferred rules on its investment income from its assets under the laws of the country in which the FFI is established or operates due to its status as a retirement/pension fund; or the taxation of investment income attributable to the beneficiary is deferred under the laws of such jurisdiction when the benefits are paid to the beneficiary;*

*(d) 50 percent or more of the total contributions to the FFI (other than transfers of assets from other plans described in this paragraph (f)(2)(ii) or §1.1471-6(f) or accounts described in paragraph (b)(2)(i)(A)) are from the government and the employer;*

*(e) No single beneficiary has a right to more than 20% of the FFI's assets."*

ASFA rejects any suggestions that the Australian superannuation system can be actively used by U.S. persons for tax evasion purposes. The Australian superannuation system is one of the most mature superannuation systems in the world and has a legislative and regulatory framework surrounding it to ensure that superannuation in Australia is used for retirement purposes. As such, Australian superannuation arrangements represent a low risk of tax evasion for FATCA purposes.

Our previous submissions have set out ASFA's reasons for believing that the Australian superannuation system represents a low risk of tax evasion. The characteristics of Australia's retirement saving systems and the appropriate regulatory framework are described below.

For an entity to be treated as a retirement fund in Australia, a number of conditions must be satisfied, including:

- The sole purpose test – this is a legislative requirement and means that the entity must be maintained for the sole purpose of providing retirement benefits or earlier death (and other similar approved benefits). Other approved benefits include employment termination insurance, income protection and other benefits. The legislation stipulates that a regulated entity cannot be used to provide pre-retirement benefits to members, employer sponsors or to facilitate estate planning.

- The residency of the entity – this is a legislative requirement and means that the fund must be an Australian resident fund. The residency test requires the fund to be established in Australia, have its central management and control in Australia and have the majority of

interests held by members that are Australian residents.

For example, a U.S. resident could not open up an account in a self-managed super fund (SMSF) as this would most likely result in the SMSF losing its residency status which would result in the fund being a non-complying fund. For a fund to be a complying fund in Australia, the central management and control of the fund is required to be ordinarily exercised in Australia. In this case, non-residents cannot establish a complying SMSF in Australia as the fund would fail the residency test as the members/trustees would not ordinarily be Australian residents. Non-complying funds are subject to tax on contributions and income at the rate of 46.5%.

- Regulatory requirements under the Superannuation Industry (Supervision) (SIS) legislation – these requirements cover operational aspects of the fund including when and what contributions can be accepted (including the need for the fund to have the member's Australian tax file number (TFN) for any member contributions to be accepted by the fund), the timing and type of benefit payments (including the preservation rules), investment restrictions, and so on.

All Australian retirement funds are regulated. The Australian Prudential Regulatory Authority (APRA) has the responsibility to regulate superannuation entities other than SMSFs. The Australian Taxation Office (ATO) regulates SMSFs.

For an Australian retirement fund to be concessionally taxed on its contribution and investment income it is required to satisfy the sole purpose test and other regulatory reporting requirements outlined above. Non-compliance with the requirements results in 46.5% tax being imposed.

Importantly, contributions can be traced through the Australian superannuation system due to the Australian annual contribution reporting requirements. Funds are required to report contributions to the ATO using the member's Australian Tax File Number (TFN), which is the equivalent of a U.S. taxpayer identification number (TIN). Employer contributions must be accompanied by the employee's TFN, or this TFN must be provided to the fund prior to the following 30 June after the contribution date. Otherwise, the contribution is subject to tax at 46.5% rather than the usual 15%. All other contributions must be accompanied by the member's TFN or the fund must immediately refund the contributions back to the contributor. Funds must provide the following details to the ATO in relation to all types of contributions received during the year, including but not limited to the:

- Contributor's name
- Member's name and address
- Member's TFN
- Amount of contribution.

Funds must provide this information to the ATO by 31 October following each 30 June (the Australian year end), to enable the ATO, amongst other purposes, to enforce the statutory contribution limits and impose any taxes on excess contributions received by the funds.

From a benefit payment perspective, a number of issues have arisen in Australia relating to benefit payments for individuals who depart permanently from Australia in the past. To avoid these issues, the Australian Department of Immigration advises the ATO of the expiry of temporary resident visas, for all persons in Australia on such visas, within six months of the departure of these persons from Australia. From its records of contributions, the ATO then determines the fund(s) to which contributions for these persons were made, and requires these funds to pay out these persons immediately (including the imposition of a 35% further withholding tax on any contributions or earnings that had until that time borne tax at 15% in the fund). The combination of the 15% tax and this further 35% withholding tax means that the person will have borne Australian tax broadly equivalent to our highest individual tax rate on salary or wages income.

In all other cases (e.g. members who are Australian citizens or permanent residents), moneys are not able to be paid out to members under the Australian preservation rules until:

- The member has reached age 65
- The member has reached their preservation age (between age 55 and 60 years depending on the individual's date of birth) and retired from gainful employment
- Death, permanent disablement, or terminal medical condition
- Severe financial hardship (this is limited to $10,000 payout only)
- Compassionate grounds, subject to the relevant regulator's approval.

Given Australia's complex regulatory environment and penalty tax rate on non-compliance, it is unlikely that the superannuation system would be used by U.S. persons for the purposes of tax avoidance. In essence, Australia's superannuation system poses a relatively low risk of tax avoidance, therefore, within the intent of the exemption, regulated Australian superannuation entities should be treated as deemed compliant.

Without prejudicing ASFA"s position as outlined above, ASFA also suggests that the above proposed amendment could be modified to exclude smaller funds from the FATCA deemed compliance retirement fund category.

However, ASFA in no way accepts that any Australian retirement fund is not a legitimate retirement fund or that the accounts in those funds are not legitimate retirement savings accounts. ASFA strongly discourages the U.S. from modifying the above suggested amendment to the FATCA deemed compliance retirement fund category.

Such an amendment to condition (vi) could be as follows:

*vi. No single beneficiary has a right to more than 20% of the FFI's assets and at least one of the following applies:*

*(f) The FFI is unable to accept personal contributions for a beneficiary under the law of the jurisdiction in which the FFI is established or in which it operates without the FFI having identifiers to identify the individual for income tax purposes in the jurisdiction in which the FFI is established or in which it operates;*

*(g)* *Contributions to the FFI that would otherwise be subject to tax under the laws of the jurisdiction where the FFI is established or operates are deductible or excluded from gross income of the beneficiary;*

*(h)* *The FFI is subject to tax-preferred rules on its investment income from its assets under the laws of the country in which the FFI is established or operates due to its status as a retirement/pension fund; or the taxation of investment income attributable to the beneficiary is deferred under the laws of such jurisdiction when the benefits are paid to the beneficiary;*

*(i)* *50 percent or more of the total contributions to the FFI (other than transfers of assets from other plans described in this paragraph (f)(2)(ii) or §1.1471-6(f) or accounts described in paragraph (b)(2)(i)(A)) are from the government and the employer.*

As indicated above, ASFA rejects any suggestions that Australian SMSFs/Small APRA funds (SAFs) are not bona fide retirement funds and are used for anti-avoidance purposes.

SMSFs/SAFs are regulated under the SIS legislation as are other Australian retirement funds. The Australian tax concessions for SMSFs/SAFs are the same as those tax concessions applying to other Australian retirement funds and are closely linked to SMSFs/SAFs being legitimate retirement funds. The Australian requirement relating to the central management and control of Australian retirement funds and the consequences that arise from non-residents from making contributions to these funds make it extremely unlikely that such funds would be used for tax avoidance purposes by U.S. residents. In such circumstances, the contributions and investment earnings of the fund would be taxed at 46.5% in Australia which reduces any incentive to use a SMSF/SAF for tax avoidance purposes.

ASFA can see no reason why the preferred recommendation for a third category of deemed compliant retirement fund should not be accepted.

## Clarification/confirmation required

Without prejudicing the above proposed amendment to the proposed regulations, clarification is sought in relation to the following issues based on the current wording of the proposed regulations:

1. Where any account value/asset value tests are included in the deemed compliant tests, the regulations should specify:

   - The point of time when the test is to be satisfied

   - The valuation method to be used

   - Whether a period of grace will be included in the test during which time the fund can rectify the account balance/asset ratio so that the fund can continually be a deemed compliant fund provided appropriate action is taken

2. Whether the exempt beneficial owner deemed compliant category requires the relevant retirement plans to be government sponsored/supported

3. The use of the term "regulated" in the context of the exceptions to the definition of 'financial accounts' and whether a look-through approach will be adopted (i.e. whether the underlying member accounts of a retirement fund will be considered regulated where the retirement fund is a regulated fund)

4. For the purposes of the definition of "financial account", the term "specified retirement age" includes a reference to the preservation age specified in the account's home country jurisdiction.

ASFA also requests confirmation of our understanding that Australian retirement funds will satisfy the requirement in section 1.1471-6(f)(1)(ii) that tax on investment income attributable to the member is deferred given that, in an Australian context, the investment income attributable to the member is not taxable to the member until the member takes their retirement benefits out of the Australian retirement system even though that income is taxable to the fund in the year that it is derived by the fund.

* * * * * *

To assist with your deliberations, ASFA would be happy to prepare a more detailed paper regarding the various components of the proposed deemed compliant categories for retirement funds and the retirement account exception.

If you have any queries in relation to the above submission, please contact Robert Hodge, Principal Policy Adviser, on +61 2 8079 0806.

Yours sincerely

Margaret Stewart
General Manager, Policy and Industry Practice

# Appendix A

We have identified a number of categories and conditions within those categories that could be satisfied for a foreign retirement fund to have deemed compliant status. A summary of those conditions and the likelihood of an Australian retirement fund satisfying those conditions are summarised in the following table:

| | Category | Deemed compliant retirement funds | | Exempt beneficial owner | | In the Australian context |
|---|---|---|---|---|---|---|
| | **Tests to be satisfied** | **Fund with 20+ members** | **Fund with <20 members** | **Tax exempt treaty country fund** | **Other funds** | **Likelihood of Australian retirement funds satisfying the requirement** |
| 1. | Retirement fund under the laws of the home country | ✓ | ✓ | | ✓ | Most likely |
| 2. | Operated principally to provide pension or retirement benefits | | | ✓ | | Yes |
| 3. | All contributions are employer, government or employee contributions | ✓ | | | ✓ | Extremely unlikely |
| 4. | Contributions are limited by reference to earned income | ✓ | ✓ | | ✓ | Extremely unlikely |
| 5. | No single beneficiary has a right to more than 5% of the fund's assets | ✓ | | | ✓ | Likely by most large funds.<br>However, further clarification is required. |
| 6. | Employer-sponsored but not by an FFI | | ✓ | | | Most likely |
| 7. | Non-residents are not entitled to more than 20% of the fund's assets and not more than $250,000 | | ✓ | | | Likely by most large funds |
| 8. | Established in a U.S. income treaty country and is generally exempt from tax in that home country | | | ✓ | | Likely by a small number of government sponsored funds |
| 9a | Is entitled to treaty benefit on income that the fund derives from U.S. sources | | | ✓ | | This depends upon the terms of the treaty |
| 9b. | Contributions that would otherwise be taxable are deductible or excluded from members gross income<br>OR<br>Tax on investment income attributable to the member is deferred<br>OR<br>50% or more of total contributions to the fund are from the government and the employer | ✓<br><br>✓<br><br>✓ | | | | Most likely<br><br>Yes – but clarification is required<br><br>Most likely |
| 9c | Exempt from tax on investment income due to status as retirement plan under the home country law<br>OR<br>50% or more of total contributions to the fund are from the government and the employer | | | | ✓<br><br>✓ | Likely by a small number of government sponsored funds<br><br>Most likely |