Australian Taxation

Wiki

To **tax** (from the Latin *taxo*; "I estimate", which in turn is from *tangō*; "I touch") is to impose a financial charge or other levy upon a **taxpayer** (an individual or legal entity) by a state or the functional equivalent of a state such that failure to pay is punishable by law.

Taxes are also imposed by many subnational entities. Taxes consist of direct tax or indirect tax, and may be paid in money or as its labour equivalent (often but not always unpaid labour). A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government […] a payment exacted by legislative authority." A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government […] whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise, subsidy, aid, supply, or other name."

The legal definition and the economic definition of taxes differ in that economists do not consider many transfers to governments to be taxes. For example, some transfers to the public sector are comparable to prices. Examples include tuition at public universities and fees for utilities provided by local governments. Governments also obtain resources by creating money (e.g., printing bills and minting coins), through voluntary gifts (e.g., contributions to public universities and museums),by imposing penalties (e.g., traffic fines), by borrowing, and by confiscating wealth. From the view of economists, a tax is a non-penal, yet compulsory transfer of resources from the private to the public sector levied on a basis of predetermined criteria and without reference to specific benefit received.

In modern taxation systems, taxes are levied in money, but in-kind and *corvée* taxation are characteristic of traditional or pre-capitalist states and their functional equivalents. The method of taxation and the government expenditure of taxes raised is often highly debated in politics and economics. Tax collection is performed by a government agency such as Canada Revenue Agency, the Internal Revenue Service (IRS) in the United States, or Her Majesty's Revenue and Customs (HMRC) in the UK or the ATO in Australia. When taxes are not fully paid, civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) may be imposed on the non-paying entity or individual.

Theory relating to the tax base.

Horizontal equity and the choice of tax base

Going back at least to Adam Smith, economists have asserted what the base for taxation should be (along with the degree of progressivity, given the chosen tax base).

The Meade Report (The Structure and Reform of Direct Taxation, Report of a Committee chaired by Professor J. E. Meade, London: George Allen & Unwin, 1978). states:

”No doubt, if Mr Smith and Mr Brown have the same ‘taxable capacity’, they should bear the same tax burden, and if Mr Smith’s taxable capacity is greater than Mr Brown’s, Mr Smith should bear the greater tax burden. But on examination ‘taxable capacity’ always turns out to be very difficult to define and to be a matter on which opinions will differ rather widely.”

This is a definition of an ideal tax base, in the sense that it is underpinned by a direct view or argument about what is ideal. But it still relies on a further definition of taxable capacity, and reflecting the acknowledged difficulty in defining taxable capacity, the Report goes on to ask: “Is it similarity of opportunity or similarity of outcome which is relevant?” and “Should differences in needs or tastes be considered in comparing taxable capacities?”Historically, the debate over the appropriate base for annual taxation has been an argument between two approaches. One is that total (Haig-Simons) income is the best measure of ability to pay and therefore horizontal equity calls for Haig-Simons income as the tax base.

The other, argued particularly in Kaldor (1955), is that annual consumption is the best measure of ability to pay and therefore **horizontal equity** calls for consumption as the tax base. This latter view is generally supported by the further argument that it is better to tax people on what they take from the economy (consumption) than a measure of what they provide (income).
There is also the concept of **vertical equity**, like should be treated alike. It should not be possible to avoid taxation by re-arranging one’s affairs.

Tax avoidance is the *legal* utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. By contrast, **tax evasion** is the general term for efforts to not pay taxes by *illegal* means. The term **tax mitigation** is a synonym for *tax avoidance*. Its original use was by tax advisors as an alternative to the pejorative term *tax avoidance*. Latterly the term has also been used in the tax regulations of some jurisdictions to distinguish tax avoidance foreseen by the legislators from tax avoidance which exploits loopholes in the law.

Country of residence

One way a person or company may lower taxes is by changing one's tax residence to a tax haven, such as Monaco, or by becoming a perpetual traveler. Some countries, such as the U.S., tax their citizens, permanent residents, and companies on all their worldwide income. In these cases, taxation cannot be avoided by simply transferring assets or moving abroad.

The United States is unlike many other countries in that its citizens and permanent residents are subject to U.S. federal income tax on their worldwide income even if they reside temporarily or permanently outside the United States. U.S. citizens therefore cannot avoid U.S. taxes simply by emigrating. According to *Forbes* magazine some nationals choose to give up their United States citizenship rather than be subject to the U.S. tax system; however, U.S. citizens who reside (or spend long periods of time) outside the U.S. may be able to exclude some salaried income earned overseas (but not other types of income unless specified in a bilateral tax treaty) from income in computing the U.S. federal income tax. The 2008 limit on the amount that can be excluded was US$87,000.

A **tax haven** is a country or territory where certain taxes are levied at a low rate or not at all.

Individuals and/or corporate entities can find it attractive to move themselves to areas with reduced or nil taxation levels. This creates a situation of tax competition among governments. Different jurisdictions tend to be havens for different types of taxes, and for different categories of people and/or companies.

There are several definitions of tax havens. *The Economist* has tentatively adopted the description by Geoffrey Colin Powell (former economic adviser to Jersey): "What ... identifies an area as a tax haven is the existence of a composite tax structure established deliberately to take advantage of, and exploit, a worldwide demand for opportunities to engage in tax avoidance." *The Economist* points out that this definition would still exclude a number of jurisdictions traditionally thought of as tax havens. Similarly, others have suggested that any country which modifies its tax laws to attract foreign capital could be considered a tax haven. According to other definitions, the central feature of a haven is that its laws and other measures can be used to evade or avoid the tax laws or regulations of other jurisdictions.

In its December 2008 report on the use of tax havens by American corporations, the U.S. Government Accountability Office was unable to find a satisfactory definition of a tax haven but regarded the following characteristics as indicative of a tax haven:

1. nil or nominal taxes;
2. lack of effective exchange of tax information with foreign tax authorities;
3. lack of transparency in the operation of legislative, legal or administrative provisions;
4. no requirement for a substantive local presence; and
5. self-promotion as an offshore financial center.

For example, last week we considered hedge funds.

Hedge fund structure

A hedge fund is a vehicle for holding and investing the money of its investors. The fund itself has no employees and no assets other than its investment portfolio and cash. The portfolio is managed by the investment manager, which is the actual business and has employees.

As well as the investment manager, the functions of a hedge fund are delegated to a number of other service providers. The most common service providers are:

Prime broker – prime brokerage services include lending money, acting as counterparty to derivative contracts, lending securities for the purpose of short selling, trade execution, clearing and settlement. Many prime brokers also provide custody services. Prime brokers are typically parts of large investment banks.
Administrator – the administrator typically deals with the issue and redemption of interests and shares, calculates the net asset value of the fund, and performs related back office functions. In some funds, particularly in the U.S., some of these functions are performed by the investment manager, a practice that gives rise to a potential conflict of interest inherent in having the investment manager both determine the NAV and benefit from its increase through performance fees. Outside of the U.S., regulations often require this role to be taken by a third party.
Distributor - the distributor is responsible for marketing the fund to potential investors. Frequently, this role is taken by the investment manager.

Domicile

The legal structure of a specific hedge fund – in particular its domicile and the type of legal entity used – is usually determined by the tax environment of the fund's expected investors. Regulatory considerations will also play a role. Many hedge funds are established in offshore financial centres so that the fund can avoid paying tax on the increase in the value of its portfolio. An investor will still pay tax on any profit it makes when it realizes its investment, and the investment manager, usually based in a major financial centre, will pay tax on the fees that it receives for managing the fund.

Around 60% of the number of hedge funds in 2009 were registered in offshore locations. The Cayman Islands was the most popular registration location and accounted for 39% of the number of global hedge funds. It was followed by Delaware (US) 27%, British Virgin Islands 7% and Bermuda 5%. Around 5% of global hedge funds are registered in the EU, primarily in Ireland and Luxembourg.

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Key features of recent tax reforms in Australia are described below.

Indirect Tax

A 10 per cent Goods and Services Tax (GST) on most goods and services consumed in Australia was introduced on 1 July 2000. Implementing a broad based, indirect tax system more reasonably shares the tax burden. The GST revenue is paid to State and Territory Governments, providing them with funding for services, such as health and education. Industry costs have reduced due to the replacement of the old wholesale sales tax and other embedded taxes with the GST.

Financial institutions duty and stamp duty was removed on most share transactions from 1 July 2001.

Personal Tax

The new thresholds resulting from the most recent review of Australia's personal tax scales are in place for income years beginning 2005-06.

- Excess imputation credits are refunded.
- The capital gains tax rate for individuals has been halved.

Business Tax

From 1 July 2001, the following reforms have applied:

- a reduction in the company tax rate to 30 per cent;
- a unified capital allowance regime; and
- an extension to the thin capitalisation regime, which serves to prevent multinational corporations from allocating a disproportionate amount of debt to their Australian operations.

From 1 July 2002 the following reforms have applied:

- the consolidations regime that allows company groups to lodge a single tax return and helps to overcome tax impediments to restructuring;
- the demerger provisions to further facilitate group restructuring; and
- the simplified imputation regime.

Leasing

The Government has announced a commitment to reforms of the existing tax treatment of leasing and similar arrangements between taxpayers on the one hand and tax-exempt and non resident end users on the other, for the financing and provision of infrastructure and other assets.

Taxation of Financial Arrangements (TOFA)

The Government has implimented two stages of its four stage reform of provisions regarding the taxation of financial arrangements and has announced a timetable to implement further reforms recommended in the Ralph Report on business taxation.

New provisions that determine whether an interest in an entity is ‘debt’ or ‘equity’ have been introduced, as have new provisions for the taxation of foreign currency denominated transactions.

New tax-timing arrangements including a mark-to-market election, an accruals/realisation framework, hedging rules generally, disposal rules, and synthetic arrangements will not commence before 1 July 2005.

International Tax Review

In May 2003, the Government announced its response to the Board of Taxation's review of International Taxation Arrangements. The reforms are designed to improve the competitiveness of Australian companies with offshore operations. They will also encourage foreign groups to establish regional headquarters in Australia and improve Australia's attractiveness as a continuing base for multinational companies. In particular, the reforms will enhance the competitiveness and reduce the compliance costs of Australian-based managed funds. Changes to Foreign Investment Fund and Interest Withholding Tax, as outlined below, have occurred as a result.

For more information see International Taxation Arrangements

Foreign Investment Fund (FIF) Changes

Qualifying superannuation entities and fixed trusts where all the beneficiaries are complying superannuation entities are exempt from the FIF rules for income years beginning on or after 1 July 2003.

The FIF balanced portfolio exemption threshold has been increased from 5 per cent to 10 per cent for income years beginning on or after 1 July 2003. The management of funds has been removed from the FIF ‘blacklist’.

Interest Withholding Tax (IWT)

Australian widely held public unit trusts are exempt from IWT on interest paid on widely distributed debentures issued to non residents. This change applies to all qualifying debentures issued on or after 23 June 2004.

Foreign Income Concessions and Exemption Changes

The amount of capital gain or capital loss that will be subject to Australia’s capital gains tax rules has been reduced or eliminated, with effect from 1 April 2004, where Australian companies (or Australian controlled foreign companies) sell shares in a foreign company with an underlying active business.

The exemptions for foreign non-portfolio dividends and foreign branch profits have also been extended to all countries, for dividends paid after 30 June 2004.

Taxation Individuals

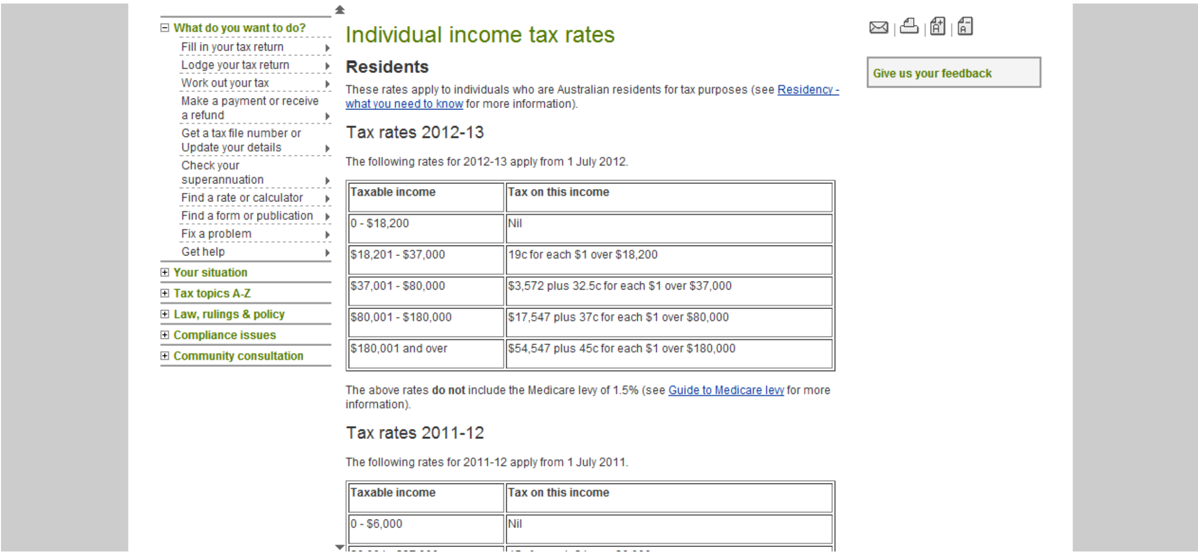
Generally, Australia distinguishes between residents and non residents for taxation purposes. Residents are taxed on their worldwide income and non residents only on their Australian source income.

Residence

An individual is resident in Australia if they 'reside' here, which is essentially a question of fact and circumstances, or if they satisfy any of the following three statutory tests:

- Domicile test - an individual will be a resident if their domicile is in Australia, unless the Commissioner is satisfied that his/her permanent place of abode is outside Australia;
- 183 day test - an individual will be a resident if he/she has spent a total of more than 183 days in a year in Australia, unless the Commissioner is satisfied that his/her usual place of abode is elsewhere, and that he/she does not intend to take up residence in Australia; or
- Commonwealth superannuation test - an individual is a resident under this test if he/she is a contributing member (or is the spouse or child under 16 of a contributing member) of the superannuation fund for Commonwealth government officers.

Individual income tax rates



What do you want to do?
Fill in your tax return
Lodge your tax return
Work out your tax
Make a payment or receive a refund
Get a tax file number or Update your details
Check your superannuation
Find a rate or calculator
Find a form or publication
Fix a problem
Get help
Your situation
Tax topics A-Z
Law, rulings & policy
Compliance issues
Community consultation

Individual income tax rates

Residents

These rates apply to individuals who are Australian residents for tax purposes (see Residency - what you need to know for more information).

Tax rates 2012-13

The following rates for 2012-13 apply from 1 July 2012.

Taxable income	Tax on this income
0 - $18,200	Nil
$18,201 - $37,000	19c for each $1 over $18,200
$37,001 - $80,000	$3,572 plus 32.5c for each $1 over $37,000
$80,001 - $180,000	$17,547 plus 37c for each $1 over $80,000
$180,001 and over	$54,547 plus 45c for each $1 over $180,000

The above rates **do not** include the Medicare levy of 1.5% (see Guide to Medicare levy for more information).

Tax rates 2011-12

The following rates for 2011-12 apply from 1 July 2011.

Taxable income	Tax on this income
0 - $6,000	Nil

Give us your feedback

Taxation - Companies

Company Tax Rate

Companies in Australia are taxed at a rate of 30 per cent. Resident companies are taxed on their worldwide income and non resident companies on their Australian source income. See also International Tax Arrangements.

A New Consolidation Regime

From 1 July 2002, wholly-owned corporate groups have the option of being taxed as a single entity for income tax purposes. The consolidation regime brings flexibility and reduced compliance costs for Australian businesses.

Imputation System

To avoid the double taxation of company profits at both the company and shareholder level, an imputation system applies. Resident shareholders are allowed a credit for the tax paid by an Australian resident company on its profits when the dividends they receive are 'franked'.

In addition, as of 1 July 2000, shareholders with a marginal income tax rate less than the company tax rate have been entitled to a refund of the excess amount of imputed tax paid at the company level.

Indirect Tax (Excise)

Companies in Australia manufacturing tobacco and tobacco products, alcoholic beverages other than wine, and petroleum products are required to be licensed under excise legislation and pay excise duties.

Company tax rates

Company tax rates

Tax rates 2011-12

The following rates of tax apply to companies for the 2011-12 income year.

Companies	Rate %
This includes corporate limited partnerships, strata title bodies corporate, trustees of corporate unit trusts and public trading trusts	30
Life insurance companies	
Ordinary class of taxable income	30
Complying super and first home saver account (FHSA) class of taxable income	15
Additional tax on no-TFN contributions income where the company is a retirement savings account (RSA) provider	31.5
RSA providers other than life insurance companies	
The RSA component of taxable income	15
Additional tax on no-TFN contributions income	31.5
The FHSA component (if any) of taxable income	15

International Taxation Arrangements

Double Taxation Agreements

To date, Australia has Double Taxation Agreements (DTA) with: Argentina, Austria, Belgium, Canada, China, Czech Republic, Denmark, Fiji, Finland, France, Germany, Hungary, India, Indonesia, Ireland, Italy, Japan, Kiribati, Korea, Malaysia, Malta, Mexico, Netherlands, New Zealand, Norway, Papua New Guinea, Philippines, Poland, Romania, Russia, Singapore, Slovakia, South Africa, South Korea, Spain, Sri Lanka, Sweden, Switzerland, Taipei, Thailand, the United Kingdom, the United States and Vietnam.

For access to the legislation visit: http://www.austlii.edu.au/au/other/dfat/

Foreign Tax Arrangements

Australian residents are generally taxed on their worldwide income, but a 'direct' credit will be allowed for foreign tax paid on foreign income, up to the amount of Australian tax payable in respect of that income.

Generally, no foreign tax credits are available for foreign tax paid on non-portfolio dividends paid to a resident company by a foreign company (since these dividends are exempt from Australian tax). Similarly no foreign tax credits are available for foreign tax paid by an Australian company on its branch profits that are exempt from Australian tax.

Foreign tax credits are available for foreign tax paid or deemed to have been paid on Controlled Foreign Company (CFC) and Foreign Investment Fund (FIF) income that is included in the assessable income of resident taxpayers.

Transfer Pricing

Australia's transfer pricing rules are designed to prevent profits being artificially transferred out of the country, primarily via inter-company and intra-company transfer pricing. Australia's rules are designed to conform to the Organisation for Economic Co-operation and Development's arm’s length principle.

Taxpayers are able to seek Advance Pricing Arrangements with the Australian Taxation Office that provides them with some certainty for a fixed period in relation to the prices considered acceptable in any assessment of their operations.

Dividends, Interest and Royalties

Dividends, interest and royalties are generally included in the assessable income of residents.

Dividends, interest and royalties paid to non residents are subject to withholding tax. While the liability to pay the withholding tax is imposed upon the recipient of the income, the tax is actually withheld and remitted to the ATO by the payer of the income. However, where the income is paid to an intermediary in Australia, then the tax may be payable by the intermediary.

The rate of the withholding tax varies, and is determined by a number of factors including whether a Double Taxation Agreement is in place with the recipient's home country, whether any dividends have been franked or whether certain withholding tax exemptions apply. See also Interest Withholding Tax.

Offshore Banking Units

Income (excluding capital gains) derived by an Offshore Banking Unit from offshore banking activities is concessionally taxed at a rate of 10 per cent and attracts interest withholding tax concessions. See Offshore Banking Regime.

Superannuation

Under Australia's compulsory Superannuation Guarantee system, employers are generally required to contribute nine per cent of the salary/wage of any employee working in Australia into an Australian complying superannuation fund.

Recent Government initiatives now allow certain temporary residents to access this superannuation (subject to a withholding tax) when permanently departing Australia. In addition, Australia has entered into Social Security treaties with a number of countries which include provisions to eliminate the problem of 'double coverage'.

Double coverage can arise where an employer is required to pay superannuation contributions in Australia for an employee temporarily working in Australia as well as equivalent contributions in the employee's home country. Under these treaties the employer may be exempt from making Superannuation Guarantee contributions if they continue to contribute in the employee's home country.

Further information on both the temporary resident measure and treaties dealing with double coverage is available at http://www.ato.gov.au/super/.

International Tax Review

In May 2003, the Government announced reforms to Australia's international taxation arrangements. The reforms are designed to improve the competitiveness of Australian companies with offshore operations. They will also encourage foreign groups to establish regional headquarters in Australia and improve Australia's attractiveness as a continuing base for multinational companies. In particular, the reforms will enhance the competitiveness and reduce the compliance costs of Australian-based managed funds.

Changes Relevant to Fund Managers

The Government has announced changes that will see non residents become exempt from Australian Capital Gains Tax (CGT) when investing in:

- foreign assets via an Australian managed fund; and
- certain Australian assets via an Australian managed fund (in those cases where CGT would not be imposed if the assets were held directly).

Australian complying superannuation entities are now exempt from the FIF rules.

The balanced portfolio FIF exemption has been increased from 5 per cent to 10 per cent (non-exempt FIF interests will be exempt from the FIF rules where their aggregate value is less than 10 per cent of the total value of the FIF interests of a taxpayer).

Australian widely held public unit trusts are now exempt from IWT on interest paid on widely distributed debentures issued to nonresidents.

The Benefits of Reform

Removing CGT will improve the after-tax returns for non residents investing in international funds using an Australian-based funds manager, thereby making Australia a more attractive base for funds management activity.

The amendments to the FIF regime reduce the compliance costs of managed and complying superannuation funds that invest offshore and allow global firms to more easily offer new financial products and services to Australian investors.

Removing IWT reduces the borrowing costs of Australian widely held public unit trusts.

Australia's Demographics

Introduction

The Australian Government's Intergenerational Report (IGR) projects that over the next 40 years, the proportion of the population aged over 65 years will almost double to around 25 per cent. At the same time, growth in the population of traditional workforce age – 15 to 64 – is expected to slow to almost zero.

This will have a profound effect on the economy and, potentially, on our living standards. The recent stagnation of the Japanese economy has been at least partly driven by its rapidly ageing population, and provides a warning to Australia to start preparing for these issues now.

Over time, the ageing of our population will result in a greater demand for Age Pensions and health and aged care spending. And the need to keep up with changing technology and community expectations of accessing the most advanced diagnostic tests and medical treatments is putting ever increasing demands on health spending. The IGR projects that these pressures will continue.

The IGR puts together all of these major expenditure factors – health, aged care, pensions and education – and projects that spending by the Australian Government will exceed the amount it raises in taxes by around 5 per cent of GDP by 2041-42. To put this into perspective, the 2003-04 forecast is for a surplus of $4.6 billion. A budget deficit of 5 per cent of GDP would mean that for 2003-04 the deficit would be around $40 billion.

The Government's preferred solution to this challenge is to implement policies designed to grow the economy more quickly. A larger economy will provide us with higher incomes, improved living standards and better enable us to meet the costs associated with our ageing population. Further detail on these issues is contained in the Appendix.

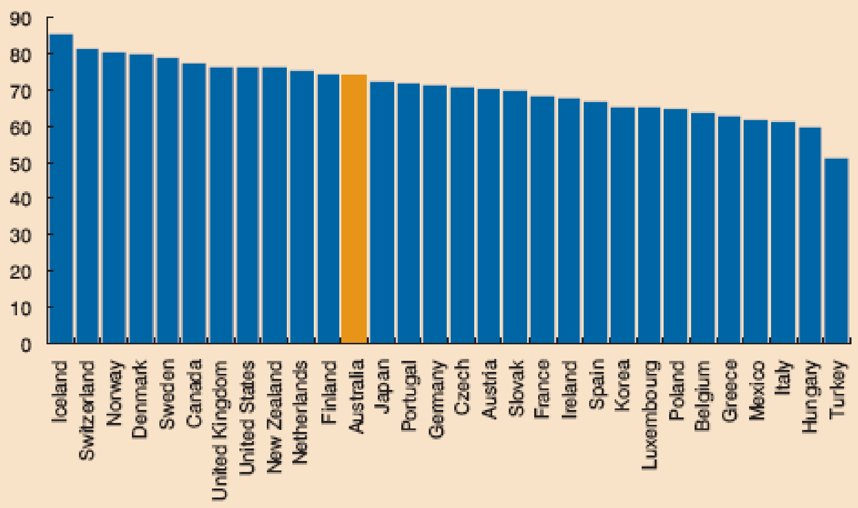
The best way to achieve higher economic growth is via increases in labour force participation and productivity.

Australia has recently enjoyed very strong productivity growth. To maintain this performance into the future we will need to continue with reforms that free-up economic activity, enhance labour market flexibility, strengthen competition, and continue to develop a more innovative and dynamic society. The gains we can make from improving productivity growth are, over the longer term, virtually unlimited. But that is not to say the task will be easy. It will also need to be accompanied by continuing sound fiscal policy and maintaining a low inflation economy.

We also have considerable potential to improve our labour force participation rates. Participating in the workforce makes people wealthier during their lives, and also means that they have higher incomes in retirement. There is also evidence that those who participate are, in general, healthier than those who do not.

Labour force participation rates are influenced by individual choices and respond to incentives and barriers. Amongst OECD countries, Australia's total participation rate ranked twelfth in 2002, suggesting we have significant potential to improve participation both in the short and medium term (Chart 1). For men aged 60 to 64, Australian participation rates ranked fourteenth. Equally, while women's participation has increased over the last 20 years, including for the mature aged, these increases were consistent with the trend across most other OECD countries, and Australia remained in the middle of the OECD for this group.

Chart 1: OECD Total Participation Rates 2002



Significant improvements in participation are possible, and will benefit those who currently are unable to find employment. The government has identified a number of opportunities to improve participation:

- improvements in the capacity for work, through better health and education
- better incentives for work
- improved flexibility in the workplace.

Our recent record of economic reform means that by comparison with other countries, which have even larger problems, Australia is among the countries best placed to deal with an ageing population. The most important thing is that we start to prepare for these changes now. In some cases this will not be easy. We must remember that many of the benefits enjoyed by Australians today are the outcomes of the sacrifices and investments of earlier generations. So too the prosperity of future generations depends upon the decisions we make today.

Equity and fairness across generations – a key building block for increasing the prosperity of nations over time – is particularly important in times of major demographic change, when the risks are higher.

By making wise investments in infrastructure, services and programs, and maintaining prudent fiscal policies we can leave future generations with an ongoing legacy of freedom, social cohesion, opportunity and prosperity.

This document sets out some of the most important issues we will need to think about over the next few years.

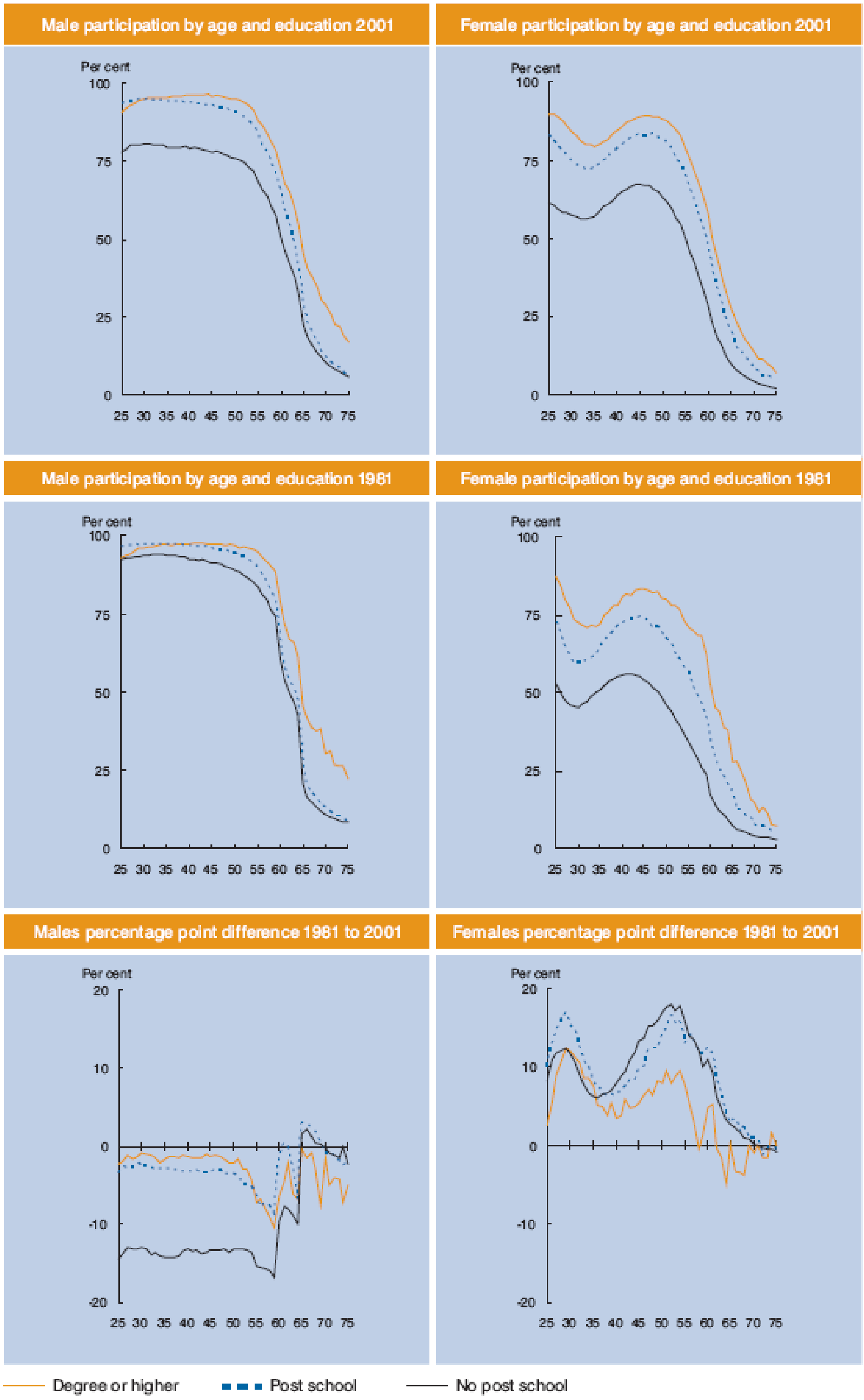
Improving the capacity for work

A key aspect of improving participation will be to ensure that all those who wish to participate have the capacity to do so. This will involve ensuring that our education system provides adequate and relevant training to equip our workers with the skills they require. In addition, our health system will need to focus both on preventing illness and injury and, where sickness and injury do occur, assisting Australians to return to health as soon as possible. Education and Skills – the key to ensuring effective partici pation

Over the last 40 years, Australia has changed dramatically. We have become more educated and skilled, and we have become more flexible, adaptable and better able to use new skills and technologies. Further increasing our skills and educational attainment will be important in improving our productivity and labour force participation. Higher skills and educational levels help in the creation of knowledge, ideas and technological innovation.

As the world around us continues to change rapidly, especially with technological change, efficient and effective post-compulsory education and training systems will become more important. Current and future workers will need to improve and continually update their skill levels.

Chart 2: Participation rates by age, educational attainment and sex



Source: Australian Bureau of Statistics, 1981 and 2001 Censuses.

Better incentives

Paid work provides us with many benefits. It provides us with the opportunity to satisfy our basic needs. It gives us the opportunity to develop personally, live independently, and interact socially. Paid work also is important in giving us the opportunity to increase our savings for retirement.

Most of us make the decision to join the workforce. However, that decision is influenced by tax arrangements, provision of income support and retirement incomes policies, all of which have an impact on whether we work and how long we work. It is important that government policies do not discourage people from working.

Incentives to work are affected by various elements of the income support system such as the maximum rates of payments, income and assets test structures, eligibility criteria attached to payments and obligations (such as requirements to look for work). Ensuring that the income support system provides an adequate safety net for those in need without providing disincentives to work requires careful balance.

It is equally important that the retirement incomes system does not encourage people to prematurely leave the workforce. For those who leave the workforce prematurely, it can be difficult to find another job. Rules about how and when people can access superannuation can significantly affect retirement decisions.

The issues about work and income supp support are wide ranging. If people receiving income support must satisfy more participation requirements, they will need additional avenues to help them get a job. How should we involve industry in assisting people off welfare and into work?

While people are in work, what actions can they take to achieve their retirement goals? Is it fair to allow those with some superannuation assets to retire early and then later call on the pension to fund the major part of their retirement?

The Income Support System

Our income support system provides people with assistance during times when they are finding it hard to support themselves. It was set up at a time when full-time work was the norm for men but many groups, such as women and people with disabilities, were not expected to have a job. Today, opportunities and expectations are different. Part-time and casual work is more common. Most women now work before and after having children. Others who worked full-time for most of their lives (such as older men) can have problems getting back into work if they lose their jobs when they are around 45 or 50. And there is a strong trend for skilled males to retire early, well before age pension age.

For most Australians, paid work provides money to live on and raise children during their working years and enjoy a higher standard of living in retirement. It also provides self-esteem and a connection to the community. At certain periods in their lives people may not be able to take up available opportunities and have to temporarily rely on income support. Others may never be fully self-reliant because of significant disability. Nevertheless, few people in the community are unable to take up paid work at some point in their lives. The income support system needs to encourage paid work, and promote and support people to participate in paid work to the extent they are able.

Around 2.7 million working-age Australians are on income support - over 20 per cent, or one in five of all adults of working age (Chart 3). This has grown by over 17 per cent from 2.3 million in 1996.

Retirement and incentives for early withdrawal from labour market.

Forty years ago, the labour force was dominated by men who started work when they turned 15 or 16 and worked till they retired at 65 on the age pension. Many spent 50 years in the workforce. Superannuation was a benefit provided to a small number of people, mainly managers in medium to large companies and public servants. The introduction of the Superannuation Guarantee has meant that 91 per cent of employees now have some form of superannuation.

Today most students complete high school and a sizeable proportion go onto further study. With people able to access their superannuation at 55 years, many of today's workforce no longer work through to a retirement age of 65. Some full time workers spend as little as 30 years in the workforce, yet life expectancy is increasing rapidly. Women in particular tend to spend less time overall than men in the workforce – primarily due to their caring responsibilities – but generally live longer. As a result, Australians are spending a greater amount of time in retirement – much of it financed either directly throught the tax system (Age Pension) or indirectly through taxation concessions (superannuation).

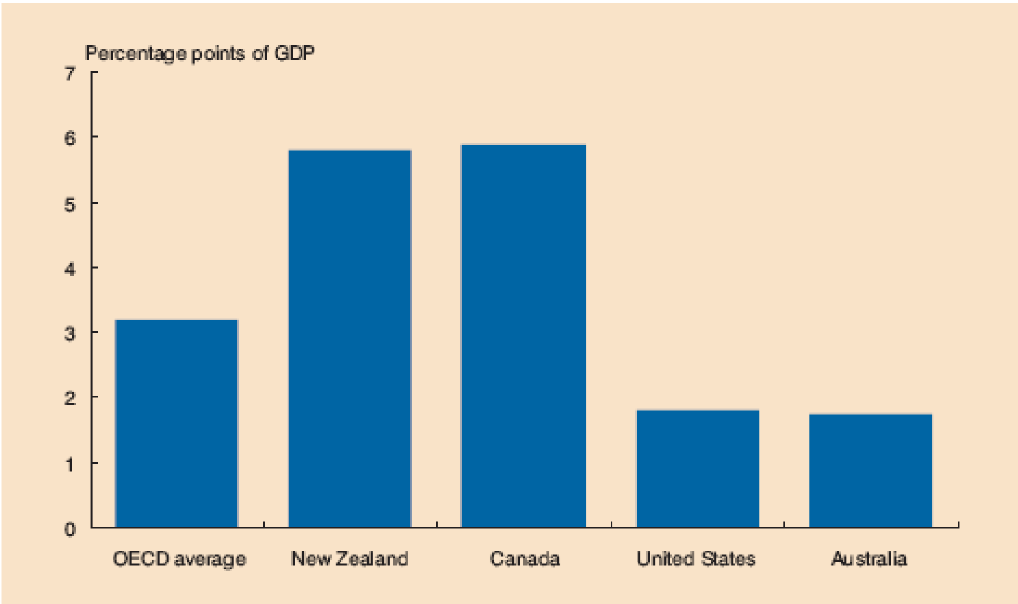
There is a direct link between the time a person spends in the workforce and their income in retirement. Workforce participation builds Superannuation Guarantee savings and also increases income and with it the ability to make voluntary savings for retirement. A person can also improve their standard of living in retirement by deferring their retirement from the workforce. This increases their superannuation savings and delays the need to drawdown on retirement savings early. The earlier retirees access their superannuation, the lower their ultimate retirement income.
That is why retirement income policies must be effective in improving retirement incomes, have community acceptance and not operate as a disincentive to remaining in the workforce. The ageing of the population also highlights the need for retirement income policy to be fiscally sustainable into the future.

Current retirement income arrangements consist of the publicly funded Age Pension, compulsory employer superannuation contributions, and voluntary superannuation and other private savings supported by tax concessions. This year, taxpayers will provide almost $19 billion to fund Age Pensions and a further $11 billion for superannuation through tax concessions. An additional $6 billion will be spent on income support payments to people aged 55 to 64. Combined, these arrangements provide Australians with higher levels of retirement incomes than before.
Over the next 40 years, Age Pension costs are projected to rise by a manageable 1.7 per cent of GDP. Many other countries are not so lucky (Chart 4).

Countries facing spiralling pension costs have needed to make some important and difficult decisions. Some, including the US and Swiss governments, have increased or are considering increasing the age pension age. The Australian Government is not considering any such change. However, the experience of other countries serves as a reminder of the budget impacts of not securing affordability before it is too late.

The combination of Age Pension, superannuation and associated tax concessions provides a firm base for most people's retirement incomes. Workers with superannuation are projected to have an average potential spending replacement rate of 66 per cent by 2042[1], that is, spending power in retirement that is 66 per cent of that before retirement.

Chart 4: International comparisons of projected increases in spending on age pensions 2000 to 2050



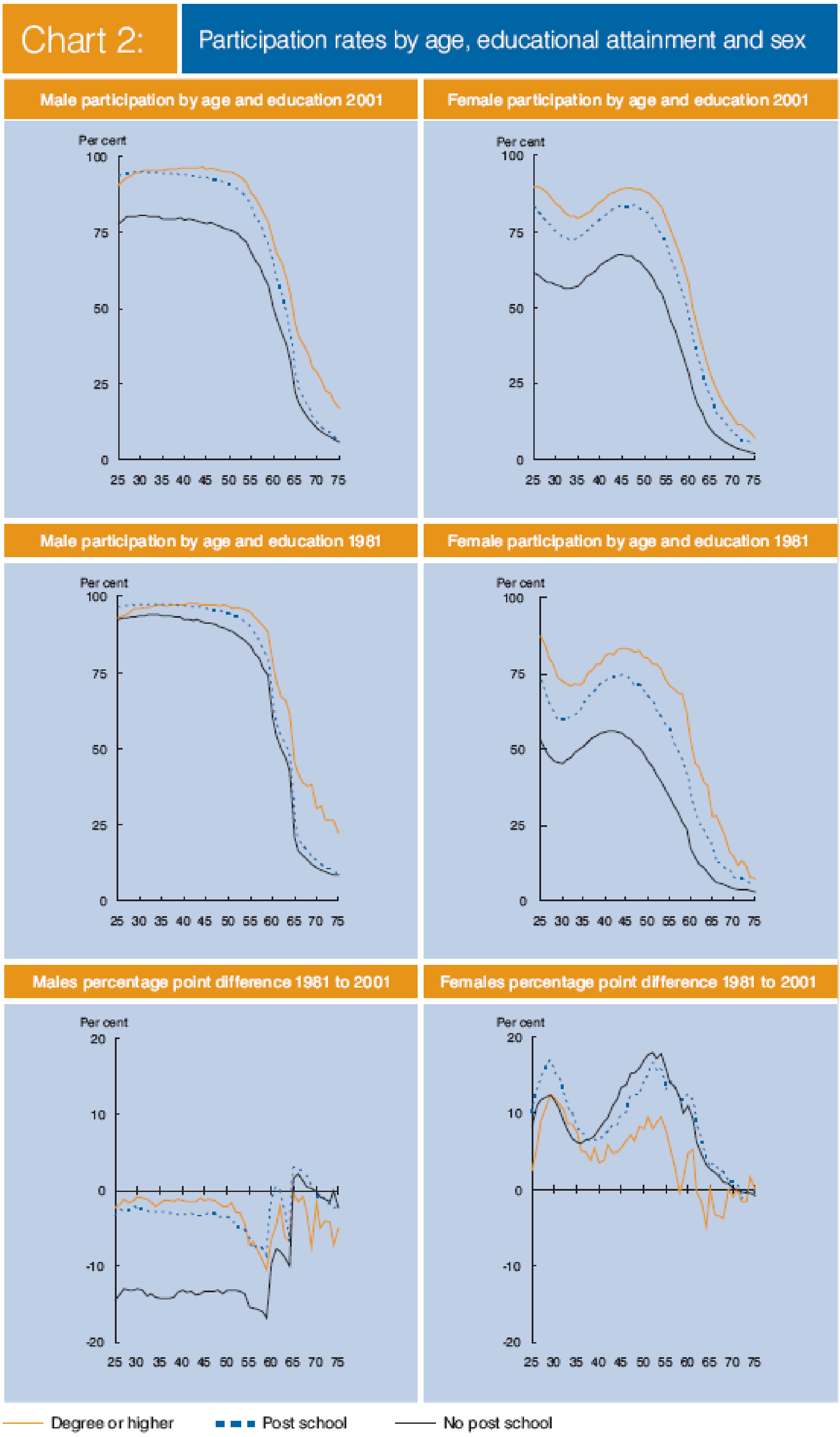
For a person who earns the median wage[2] for 40 years, compulsory superannuation and the age pension would provide a spending replacement rate of 85 per cent – 65 per cent more spending power than is available from the age pension alone. While this would provide a lower income than when a person was working, retirees' day-to-day spending needs typically would be lower. For example, fully retired people do not face work-related expenses such as clothing and transport costs, while the major costs of raising children and paying off the mortgage generally would be in the past. Therefore, a replacement rate of 84 per cent is in the range independent experts consider to be appropriate.

Although old age is inevitable, many people don't think about it until it arrives. Yet a longer lifespan means more time as an older person and more time as a retiree. That is why people need to think about their retirement income goals in advance and determine whether the combination of the Age Pension, compulsory superannuation and other savings will satisfy these goals. Those who want a more comfortable retirement have opportunities to save, including through additional concessionallytaxed superannuation contributions or through postponing retirement.

Increasingly important is the superannuation preservation age. Superannuation receives generous taxation concessions as the preferred retirement savings vehicle. The preservation age aims to ensure that these concessional superannuation benefits cannot be withdrawn before retirement. At the moment, superannuation benefits can be accessed from 55 years – ten years before Age Pension age. This might encourage people to see the preservation age as the appropriate age for retirement. For these reasons it was decided in 1997 that the preservation age will increase to 60 years by 2024.
Preservation rules that allow access to superannuation as a lump sum before Age Pension age also can encourage people to prematurely retire, run down their savings and rely on the Age Pension for their retirement.

Many people over Age Pension age have skills and experience to make them valuable employees. The Government offers incentives for people over Age Pension age to continue working, including the reduction in the Age Pension income test taper rate (introduced as part of the new tax system), Senior Australians Tax Offset and the Pension Bonus Scheme. These policies increase the rewards to people over Age Pension age who wish to keep working and have the capacity to do so.

The challenge is to achieve a balance between continuing provision of a safety net for those in need while maintaining appropriate emphasis on the value of being part of the workforce and incentives for each of us to make sufficient provision for our own retirement.



Source: Australian Bureau of Statistics, 1981 and 2001 Censuses.

Retirement and incentives for early withdrawal from labour market.

Forty years ago, the labour force was dominated by men who started work when they turned 15 or 16 and worked till they retired at 65 on the age pension. Many spent 50 years in the workforce. Superannuation was a benefit provided to a small number of people, mainly managers in medium to large companies and public servants. The introduction of the Superannuation Guarantee has meant that 91 per cent of employees now have some form of superannuation.

Today most students complete high school and a sizeable proportion go onto further study. With people able to access their superannuation at 55 years, many of today's workforce no longer work through to a retirement age of 65. Some full time workers spend as little as 30 years in the workforce, yet life expectancy is increasing rapidly. Women in particular tend to spend less time overall than men in the workforce – primarily due to their caring responsibilities – but generally live longer. As a result, Australians are spending a greater amount of time in retirement – much of it financed either directly throught the tax system (Age Pension) or indirectly through taxation concessions (superannuation).

There is a direct link between the time a person spends in the workforce and their income in retirement. Workforce participation builds Superannuation Guarantee savings and also increases income and with it the ability to make voluntary savings for retirement. A person can also improve their standard of living in retirement by deferring their retirement from the workforce. This increases their superannuation savings and delays the need to drawdown on retirement savings early. The earlier retirees access their superannuation, the lower their ultimate retirement income.

That is why retirement income policies must be effective in improving retirement incomes, have community acceptance and not operate as a disincentive to remaining in the workforce. The ageing of the population also highlights the need for retirement income policy to be fiscally sustainable into the future.

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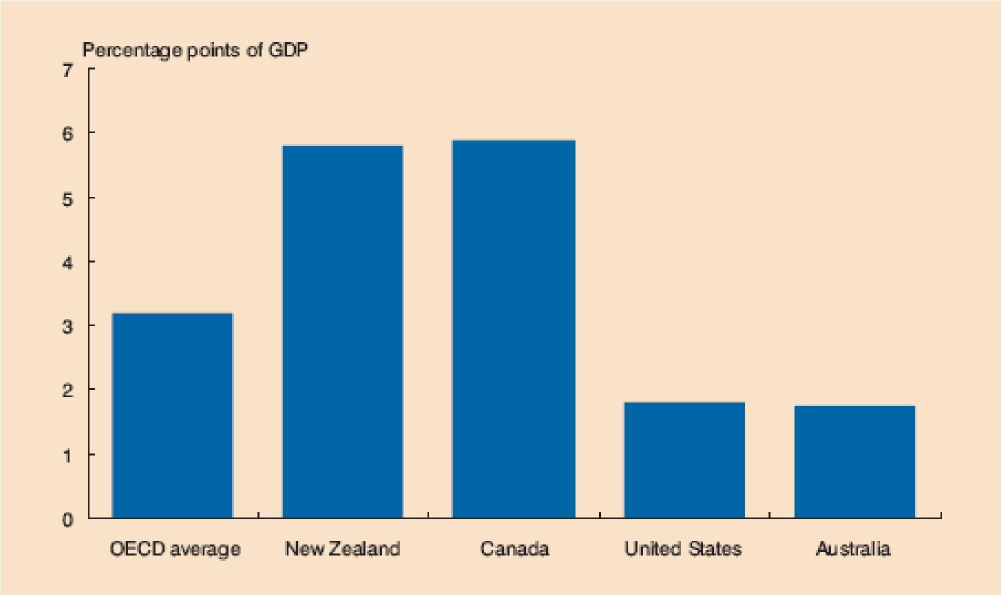

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