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From Toby Woods / Mark N. Cerché
To **General Manager**, The Treasury
Email simplersuper@treasury.gov.au

ABN 47 702 595 758

Stock Exchange Centre
530 Collins Street
Melbourne VIC 3000
Australia
Tel 61 3 9614 1011
Fax 61 3 9614 4661

Correspondence
GPO Box 1776Q
Melbourne VIC 3001
Australia
DX 30999 Melbourne
Stock Exchange

www.aar.com.au

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Dear Sir / Madam

**Submission on Plan to Simplify and Streamline
Superannuation****Persons with Pension Entitlements in Connection with
Australia's *International Organisations (Privileges and
Immunities) Act 1963***

Please find attached a copy of submissions on the Australian Government's Plan to Simplify and Streamline Superannuation made on behalf of persons with pension entitlements in connection with the *International Organisations (Privileges and Immunities) Act 1963* (Cth) (the **IO Group**).

We note that in preparing the submissions the IO Group has had the advantage of reading the submission on the Plan to Simplify and Streamline Superannuation made by Mr Leo Teller as a member of the Australian Association of Former International Civil Servants (**AAFICS**).

Whilst the submission by the IO Group goes beyond the reform proposals put forward in Mr Teller's submission, based on fundamental policy grounds, the IO Group nevertheless submits that the superannuation reforms ultimately passed should apply consistently to persons covered by the *International Organisations (Privileges and Immunities) Act 1963* (Cth).

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Please contact us should you wish to discuss any aspect of this submission.

Yours sincerely

Toby Woods

Lawyer

Toby.Woods@aar.com.au

Tel 61 3 9613 8471

Mark N. Cerché

Partner

Mark.Cerche@aar.com.au

Tel 61 3 9613 8872

Submission on Plan to Simplify and Streamline Superannuation on Behalf of Persons with Pension Entitlements in Connection with Australia's *International Organisations (Privileges and Immunities) Act 1963*

A. Introduction

1. This submission is made on behalf of a group of:
 - (a) persons currently receiving pension benefits in Australia under staff retirement plans and funds administered by international organisations covered by Australia's *International Organisations (Privileges and Immunities) Act 1963* (Cth) and regulations (the **IO Legislation**); and
 - (b) persons presently entitled to receive future benefits in Australia under retirement plans and funds administered by such organisations,

(together, the **IO Group**).
2. The group includes around 60 individuals who are pursuing, or have pursued, careers in international organisations of which Australia is a member or shareholder and which enjoy certain privileges and immunities, including tax exemptions, under the IO Legislation.¹ All are Australian citizens and/or Australian residents.
3. Such international organisations include:
 - (a) the Bretton Woods institutions, namely, the International Bank for Reconstruction and Development (the **IBRD** or **World Bank**), the International Monetary Fund (the **IMF**), the International Finance Corporation (the **IFC**), the Multilateral Investment Guarantee Agency (the **MIGA**) and the International Center for Settlement of Investment Disputes (the **ICSID**);
 - (b) multilateral development banks including the Asian Development Bank (the **ADB**), the European Bank for Reconstruction and Development (the **EBRD**) and the Inter-American Development Bank (the **IADB**); and
 - (c) the UN Group.

B. Scope and Nature of this Submission

4. The proposal in this submission is designed to advance the principles and policies underlying the proposals for reforms to Australia's superannuation arrangements, announced in the Commonwealth Budget this year and described in detail in the Commonwealth Government's paper titled 'A Plan to Simplify and Streamline Superannuation' (the **Government Plan**) released in May this year.
5. The submission deals with what appears to be a significant oversight in the reform proposals. The Government Plan sets out proposals for the treatment of benefits paid to individuals aged 60 and over with respect to payments paid from 'taxed sources'² and

¹ This submission may also cover any other IO Pensioners (defined below) receiving pensions from IO Organisations (defined below) covered by the IO Legislation.

² See Part 2 of the Government Plan.

'untaxed sources'³. The IO Pensions are not made from 'taxed sources', as defined in the Government Plan, since the contributions to the relevant staff retirement plans and funds are exempt from Australian tax. Further, under the Government Plan, the term 'untaxed sources' seems to apply fairly narrowly, to cover primarily (or solely) superannuation schemes operated by the Australian Federal, State and Territory Governments for the benefit of public servants, where employer contributions are not made until a benefit becomes payable and where no contributions or earnings tax is paid.⁴ The two categories – 'taxed' and 'untaxed' source payments – appear to cover only Australian pensions.

6. As such, pensions received from funds administered by IO Organisations (***IO Pensions***) do not appear to fall under either of the categories and the treatment of IO Pensions under the proposed reforms is therefore uncertain. However, we submit that there are sound policy reasons why IO Pensions should be included as part of the Government Plan.
7. On a simple analysis, the staff retirement plans administered by international organisations covered by the IO Legislation (the ***IO Organisations***) might be regarded as most closely analogous to 'untaxed schemes'. However, it is submitted that, since contributions to such staff retirement plans are exempt from tax by virtue of Australia's policy in relation to IO Organisations, IO Pensions should be regarded as more closely analogous to pensions paid from 'taxed schemes' and be treated under the Government's superannuation proposals accordingly. Moreover, for these same policy reasons, IO Pensions should be distinguished from other public service pensions paid from 'untaxed schemes'. Such treatment would be in line with the principles underlying the Government Plan.
8. The policy grounds which support the treatment IO Pensions in an equivalent manner to payments from 'taxed' sources are set out in detail at Part E of this paper.
9. The submission of the IO Group is therefore that the legislative reforms to Australia's superannuation arrangements should incorporate rules under which IO Pensions are to be taxed in an equivalent manner to pensions paid from 'taxed schemes'. The IO Group seeks, in particular, that IO Pension payments (including payments from pensions which commenced before 1 July 2007) be tax free when paid to persons aged 60 or over, and that such IO Pensions need not be declared in the tax return of an IO Pensioner.

C. Characteristics of IO Pensions

10. In order to determine whether, as a matter of law and policy, IO Pensions should be assessable to tax in Australia, it is important to identify the essential characteristics of IO Pensions. Those characteristics are set out in the following paragraphs.

(a) Compulsory nature of staff retirement plans

11. ***Staff contributions to IO Organisations' staff retirement plans are compulsory.*** IO Pensions are administered by IO Organisations pursuant to formal rules and regulations applicable to the relevant staff retirement fund. These rules and regulations invariably stipulate that each staff member in the IO Organisation must contribute a proportion of salary to the staff retirement plan. Employer contributions are made in respect of each

³ See Part 8 of the Government Plan.

⁴ See Part 8 of the Government Plan.

contributing staff member.⁵ For example, at the ADB, staff members must contribute 9.33% of salary and ADB contributes up to 16% of salary. Most staff retirement plans are defined benefit schemes. In some cases, the assets of the staff retirement plan are held separate from the assets of the IO Organisation and in others, the obligations under the staff retirement plan are the obligations of the IO Organisation itself.

(b) Professional administration and management of staff retirement plans

12. ***The staff retirement plans of IO Organisations are professionally administered and managed outside Australia.*** The contributed funds of these schemes are usually held in various asset classes in various currencies, with such assets and the corresponding accounts held in many cases outside Australia. Some such schemes may hold assets that include Australian securities, but income from these securities is exempt from Australian tax by virtue of the IO Legislation. The schemes are administered by the IO Organisations but employ the services of professional investment managers.

(c) Compulsory retirement age

13. ***IO Organisations stipulate a compulsory retirement age.*** The terms of employment in IO Organisations vary. However, all IO Organisations stipulate a compulsory retirement age. For example, the compulsory retirement age at Bretton Woods institutions is 62, while the compulsory retirement age at the Asian Development Bank is 60. Some staff retirement plans have provision for early retirement, with various formulae applied to calculate reduced pension payments in such cases.

(d) Benefits in form of lump sums or pensions

14. ***Upon retirement, IO Pensioners may receive benefits in the form of lump sum payments and/or pensions.*** Retirees may commute a portion of their pension entitlements and elect to receive that amount as a lump sum upon retirement. Such lump sum payments are generally paid to the IO Pensioners prior to resumption of residence in their home country (or the commencement of residence outside the country of the employment in the IO Organisation). IO Pensioners generally have the option to receive IO Pensions in United States Dollars, in the home country currency or in a combination of United States Dollars and the home country currency. The IO Organisation generally pays the IO Pension into an account of the particular IO Pensioner's choice.

(e) Retirement income and reversionary interests

15. ***IO Pensions offer retirement income and reversionary interests.*** For almost all long-term staff in IO Organisations, IO Pensions offer a secure source of retirement income. By retirement, IO Pensioners will in almost all cases have adequate self-funded retirement income, and will therefore not have to rely on an Australian Government age pension to supplement their retirement income. Upon the death of the IO Pensioner, IO Pensions usually carry reversionary rights permitting the pension to be paid, usually at reduced amounts, to the surviving spouse of the IO Pensioner.

⁵ The contributions made by IO Organisations are an 'emolument' paid for the benefit of the employee in relation to employment and therefore must be regarded as exempt from Australian tax under the IO Legislation.

(f) Exemption from tax for salaries and emoluments

16. ***In general, salaries and emoluments received from IO Organisations are exempt from Australian tax, but this may be subject to limitations.*** As referred to below,⁶ the *International Organisations (Privileges and Immunities) Act 1963* (Cth) (the **IO Act**) exempts from Australian tax the salaries and emoluments of persons working for IO Organisations, but this exemption is stated to be subject to any conditions applied by the relevant regulations (the **IO Regulations**).

D. The ATO's Current Treatment of IO Pensions

17. Under the IO Act, subject to any restrictions put in place by the IO Regulations, persons participating in the work of an IO Organisation are entitled to an exemption from taxation on salaries and emoluments received from the organisation.⁷
18. Whilst in most cases the IO Regulations applicable to each IO Organisation have only reserved for the Australian Government the right to tax individuals in relation to services performed in Australia, the view of the Australian Taxation Office (the **ATO**) seems to be that the exemption in the IO Legislation does not apply to exempt IO Pension payments from tax and that therefore the IO Pension payments will be taxed at taxpayers' marginal tax rates: see, eg, Taxation Ruling 92/14 paragraph 13. The ATO bases this view on the understanding that IO Pensions are not 'emoluments' (since they are payments to former rather than current members of the IO Organisation in question).
19. However, the ATO appears to base this view largely on a decision of the Board of Review in *Case M90 80 ATC 648*,⁸ a decision in which the Board appeared to be heavily influenced by the particular factual and legal context in which the dispute arose. The ATO's view has not been tested or reassessed following the High Court decision in *Austin v Commonwealth of Australia* (2003) 215 CLR 185 and the principles which underpinned the concept of 'remuneration' in that case. In particular, it is noted that the legislation which introduced the Contributions Surcharge Tax in respect of Federal and State judges recognised that 'remuneration' included the pensions provided to judges.
20. In fact, the better position seems to be that the IO Pensions are part of the 'salary and emoluments' provided by IO Organisations and that they are therefore exempt from Australian tax. As such, whilst most if not all persons receiving IO Pensions (**IO Pensioners**) in Australia will, following the ATO's view on the matter, treat the pension payments as assessable income for tax purposes, whether this is the correct way to treat IO Pensions for tax purposes is not at all clear. It may be that imposition of tax on IO Pensions may be inconsistent with the IO Legislation and with Australia's international obligations as reflected in the IO Legislation.
21. IO Pensioners currently follow the ATO's view on the matter and usually receive a tax offset to take into account the undeducted purchase price of their pension. This offset reflects the fact that the contributor has not received an Australian tax deduction for the contributions made.

⁶ See paragraph 17 of this paper.

⁷ See section 6(1)(e) and the Fifth Schedule of the IO Act.

⁸ See Taxation Ruling 92/14 para 14.

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22. This submission is made, however, on the basis that the ATO's current treatment of IO Pensions is not expected to change under the proposed superannuation reforms.

E. Policy Grounds for Treatment Equivalent to 'Taxed Schemes'

23. The submission of the IO Group is that the upcoming legislative reforms to Australia's superannuation arrangements should incorporate rules under which IO Pensions are taxed equivalently to payments from 'taxed schemes' (as that concept is used in the Government Plan). In particular, the IO Group seeks that IO Pension payments made to IO Pensioners aged at least 60 be tax free, and that an IO Pensioner does not need to include the IO Pension in his or her tax return.
24. It is submitted that recognition of IO Pensions under the proposed legislative reforms (the **IO Reforms**) is supported by foreign policy factors which have been consistently recognised by the Australian Government and the Department of Foreign Affairs and Trade, in particular, as important to Australia's national interests. This distinguishes IO Pensions from ordinary overseas pensions paid in connection with private sector or commercial employment. It is also submitted that the IO Reforms are consistent with and will promote the aims of the Government Plan.
25. The policy factors supporting the IO Reforms are that:
- (a) **incentive to return to Australia** – the IO Reforms will provide an incentive for IO Pensioners to return to Australia upon retirement;
 - (b) **incentive to work in IO Organisations** – the IO Reforms are needed to provide an adequate incentive for people to work in IO Organisations;
 - (c) **incentive to save for retirement** – the IO Reforms are needed to provide an adequate incentive for IO Pensioners to save for their retirement;
 - (d) **consistency with reform principles** – the IO Reforms accord with the principles set out in the Government Plan;
 - (e) **distinction from 'untaxed schemes'** – the IO Pensioners may be distinguished from persons who receive, or are to receive, pension payments under 'untaxed schemes';
 - (f) **disincentive against artificial tax structuring** – the IO Reforms provide a disincentive against artificial structuring of taxpayer superannuation benefits to reduce Australian tax; and
 - (g) **insignificant impact on revenue** – the IO Reforms would have an insignificant impact on Australian tax revenue.

These policy factors are described in detail at paragraphs 27 to 39 below.

26. The central theme underlying the policy factors is that in light of changes to the purely domestic aspects of Australia's superannuation arrangements as proposed, the continued taxation of IO Pensions at taxpayers' marginal tax rates will not only ignore the policy issues at stake, but will also fail to adequately and appropriately incentivise workers in the manner which is advocated in the Government Plan.

(a) Incentive to return to Australia to work

27. ***The IO Reforms will provide an incentive for IO Pensioners to return to Australia upon retirement.*** If the proposed superannuation reforms are made without the IO Reforms, there will be less incentive for Australians working in IO Organisations to return to Australia on their retirement. Consequently, Australia will lose the benefit of having former members of IO Organisations participating in the Australian workforce. Former members of IO Organisations who return to work in Australian organisations bring important benefits to Australia – such persons bring a wealth of international experience, world class skills and education, and a wide network of international relationships to the Australian workforce.
28. Without the IO Reforms, more Australians will choose to stay in or move to countries where they are taxed relatively more favourably than in Australia. We understand that in countries such as New Zealand, Canada, Denmark, Thailand, Philippines and Spain, IO Pensions are treated as being free from tax. Where Australians choose to continue to work overseas in their retirement, Australia will lose the skills of those involved and the tax revenue which it would otherwise have received had they returned to Australia and paid tax on their income received from the new employment or from investments held, whether in Australia or elsewhere.
29. The inadequacy of incentives for IO Pensioners to return to the Australian workforce, which will result if the IO Reforms are not adopted, needs to be considered in the context of the increasing flow of Australian intellectual capital out of Australia. This trend makes it even more important to take measures which will assist in securing the return of educated and skilled Australians to the Australian workforce, with the benefit of their global experience.
30. IO Pensioners are particularly susceptible to incentives to return to the Australian workforce, since, as discussed above, it is compulsory that they retire from the IO Organisation at a relatively early age. Thus whilst their counterparts in foreign commercial organisations other than IO Organisations may be inclined to continue their existing careers upon reaching their early sixties, IO Pensioners will be more likely to consider a return to Australia and active participation in the work force.

(b) Incentive to work in IO Organisations

31. ***The IO Reforms are needed to provide an adequate incentive for Australians to work in IO Organisations.*** If the proposed superannuation reforms are passed with the IO Reforms, there will be tremendous incentive for Australian individuals to work in IO Organisations. The involvement of Australians in IO Organisations brings important benefits to Australian government and society in that it allows for Australia's interests, policies, standards and principles to be effectively communicated and represented at a global level. From Australia's perspective, these IO Organisations operate more effectively, and therefore bring better returns to Australia, if Australians are involved in them. Moreover, the involvement of Australians in IO Organisations ensures that appropriate consideration is given to Australian organisations when consulting and other contracts are awarded by IO Organisations.
32. If there is not parity of superannuation incentives between Australians who pursue their careers in Australia and those who pursue public service careers in IO Organisations, the latter group will, in effect, in relative terms be penalised in retirement for their career

choice. There are almost no opportunities to work in similar organisations in Australia and, as such, it is necessary for Australians to relocate overseas to pursue this kind of career. As discussed, Australians who do pursue this career bring significant benefits to Australia both during their period of employment and upon their return to the Australian workforce.

33. Importantly, as referred to above, it is compulsory for employees of IO Organisations to contribute to overseas pension plans and, as such, these employees have no opportunity to contribute instead to Australian superannuation funds so as to guarantee that they will receive equal tax treatment to Australians who pursue careers in Australia.

(c) Incentive to save for retirement

34. ***The IO Reforms are needed to provide an adequate incentive for IO Pensioners to save for their retirement.*** If the IO Reforms are not accepted as part of the proposed superannuation reforms, IO Pensioners will have less incentive to fund their own retirement. In this case the Government age pension (or pension support) will become relatively more attractive. In addition, the continued inclusion of the IO Pensions in the assessable income of IO Pensioners will lead to a greater tax cost for the individual in undertaking additional work upon retirement, since the inclusion will, on average, subject the assessable income from the additional work to higher marginal tax rates.

(d) Consistency with the Government Plan

35. ***The IO Reforms accord with the principles set out in the Government Plan.*** The IO Reforms are consistent with the principles in the Government Plan and would produce the same kinds of benefits valued under the plan. In particular, as discussed above, the IO Reforms would 'send clear signals and provide appropriate incentives'⁹ to Australians in connection with the importance of such persons saving for their retirement and continuing to be engaged in the Australian workforce after their retirement from the public sector IO Organisation and their return home.¹⁰

(e) Distinction from 'untaxed schemes'

36. ***The IO Pensioners may be distinguished from persons who receive, or are to receive, pension payments under 'untaxed schemes'.*** As discussed, under the proposals contained in the Government Plan, Australians who receive pensions from 'untaxed' Australian superannuation funds will receive less favourable tax treatment of their superannuation benefits than Australians who receive pensions from the usual 'taxed' Australian superannuation funds. This difference in the treatment of the two classes of persons is said to be justified on the basis that taxes have not been paid on contributions in the untaxed schemes because these schemes are not funded until superannuation benefits are actually paid to the retiree. IO Pensions, however, may be clearly distinguished from such untaxed superannuation schemes.
37. As stated, both the staff of the IO Organisations and the IO Organisations themselves contribute to staff retirement plans during the entire course of employment. Australian taxes are not paid on contributions to these plans because of Australia's long-standing policy decision that salaries and emoluments at IO Organisations be exempt from tax. This

⁹ See Government Plan at Part 1.1, page 1.

¹⁰ See Government Plan, Part 1.1.

tax exemption is, therefore, an expression of Australian Government policy, as it relates to IO Organisations. For IO Pensions there is an overarching policy consideration – namely, the need for Australia to comply with its international obligations to extend the privileges and immunities which apply to international civil servants employed by IO Organisations. This policy clearly justifies differential tax treatment.

(f) Disincentive to artificial tax structuring

38. ***The IO Reforms will provide a disincentive against artificial structuring of taxpayer superannuation benefits to reduce Australian tax.*** If the IO Reforms are not accepted there will remain a strong incentive for IO Pensioners to structure entitlements to and payments of superannuation benefits in a complex or artificial manner in order to minimise or reduce their liability to Australian tax. It may be expected that IO Pensioners would choose to commute a large proportion of their pension entitlements to lump sums and this would almost certainly increase the risk that the persons would not be able to self fund their retirement. This is so because the conversion of an IO Pension to a lump sum is likely to be on terms favourable to the IO Organisation. Accordingly, it can be expected that the lump sum rate available will be considerably less valuable than the lifetime pension provided by the IO Organisation. In addition, there would be a greater incentive to engage in offshore tax planning and to spend excessive amounts on obtaining relevant financial advice.¹¹

(g) Insignificant impact on Australian tax revenue

39. ***The IO Reforms would have an insignificant impact on Australian tax revenue.*** At present there may be approximately 600 IO Pensioners in total, with about 10 or so who reach the age of 60 each year. Accordingly, whether or not the relative gains in Australian tax revenue (including revenue from indirect taxes and other State revenue) from attracting Australians back to work in Australia are taken into account, the reduction in tax revenue resulting from the implementation of the IO Reforms would be insignificant.

F. Conclusion

40. The IO Group seeks that the legislative reforms to Australia's superannuation arrangements include reforms under which IO Pensions are to be taxed equivalently to pensions paid from 'taxed schemes'. In particular, the IO Group seeks:
- (a) that IO Pension payments (including payments from pensions which commenced before 1 July 2007) be tax free when paid to persons aged 60 or over; and
 - (b) that such IO Pensions need not be declared in the tax return of an IO Pensioner.
41. The IO Group contends that the omission of such reforms would neglect the importance to Australia of the involvement of Australians in IO Organisations and their subsequent return to the Australian workforce.

¹¹ One of the aims of the announced superannuation reform proposals, as set out at the Government Plan at Part 1.5, is to reduce the need for Australians to acquire financial advice in relation to their individual superannuation arrangements.