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Abstract

The Transition to Retirement (TTR) provisions allow workers who have reached preservation age to access their superannuation despite not ceasing employment. Full-time mature workers commonly use these provisions for tax minimisation purposes. Such use is inconsistent with their original aim of enabling mature workers to transition to retirement by lightening their workload while accessing their superannuation to top up their reduced income. Furthermore, despite claims that the ability of full-time workers to use the TTR provisions helps to achieve certain policy goals, a number of alternative policies considered in this paper are better suited to fulfilling such goals.

Keywords

transition to retirement; TTR provisions; superannuation, mature workers, preservation age

THE TRANSITION TO RETIREMENT PROVISIONS: A CRITICAL ANALYSIS AND A CONSIDERATION OF POLICY ALTERNATIVES

RAMI HANEGBI*

The Transition to Retirement (TTR) provisions allow workers who have reached preservation age to access their superannuation despite not ceasing employment. Full-time mature workers commonly use these provisions for tax minimisation purposes. Such use is inconsistent with their original aim of enabling mature workers to transition to retirement by lightening their workload while accessing their superannuation to top up their reduced income. Furthermore, despite claims that the ability of full-time workers to use the TTR provisions helps to achieve certain policy goals, a number of alternative policies considered in this paper are better suited to fulfilling such goals.

The Transition to Retirement (TTR) provisions allow workers who have reached preservation age to access their superannuation despite not ceasing employment. Full-time mature workers commonly use these provisions for tax minimisation purposes. Such use is inconsistent with their original aim of enabling mature workers to transition to retirement by lightening their workload while accessing their superannuation to top up their reduced income. Furthermore, despite claims that the ability of full-time workers to use the TTR provisions helps to achieve certain policy goals, a number of alternative policies considered in this paper are better suited to fulfilling such goals.

INTRODUCTION

The Transition to Retirement (TTR) provisions in the superannuation legislation have now been around for a number of years. They allow people who have reached preservation age but are still working to access their superannuation through a non-commutable income stream. When these provisions were enacted they were

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primarily aimed at allowing workers who had reached their preservation age and wished to reduce their work responsibilities (usually by working part-time) to top up their reduced incomes with some of their superannuation savings. In contrast, their main use has become that of a tax minimisation vehicle for full-time workers who have reached preservation age.

Lately, there have been calls for the TTR provisions to be reviewed.¹ Whether the TTR provisions should remain in their current form depends on what their claimed justifications are, and their effectiveness in fulfilling these justifications when compared to other alternative policies.

BACKGROUND

Before the enactment of the TTR provisions, superannuation access for those who had reached the preservation age of 55 but were under 65 was generally conditional on them ceasing their employment. Furthermore, if they were under 60 an added condition was that the taxpayer had to intend to not be gainfully employed again. The TTR provisions were enacted to allow workers who had reached preservation age but had yet to cease employment to access some of their superannuation savings.

The TTR provisions were originally announced in the 2004 Federal Budget.² However, some of their operational details had yet to be finalised at the time. The government subsequently issued a consultation paper that outlined the main aims of the proposed TTR provisions.³ Specifically, this consultation paper stressed that the TTR arrangements were being introduced to prevent people from retiring early due to them wanting to access their superannuation.⁴ The paper stated that this aim would be fulfilled by giving workers transitioning towards retirement, such as by reducing their working hours, the ability to dip into their superannuation, which would give them the economic ability to sustain such an arrangement:

As the population ages, it will become increasingly important for people to retain a connection with the workforce at older ages. However, the current rules which require people below the age of 65 to retire or leave their job before they

¹ Australian Law Reform Commission, *Access All Ages—Older Workers and Commonwealth Laws* (2013) 210–11 <http://www.alrc.gov.au/sites/default/files/pdfs/publications/whole_final_report_120_.pdf> at 9 August 2013.

² Australian Government, *Budget 2004–05: Budget Paper No. 2* (2004) 17 <<http://www.budget.gov.au/2004-05/bp2/download/bp2.pdf>> at 6 December 2012.

³ Retirement Income and General Rules Unit, The Treasury, *Transition to Retirement Consultation Paper* (2004) <http://archive.treasury.gov.au/documents/928/PDF/Transition_to_retirement_Consultation.pdf> at 6 December 2012.

⁴ Ibid 3–4.

can access their superannuation benefits may lead to people deciding to retire prematurely. The current rules also do not adequately cater for more flexible workplace arrangements where people may choose to reduce their hours of work as they approach retirement.

Allowing people to access their superannuation from their preservation age without having to retire or leave their job will give them more flexibility to develop strategies in their transition to retirement. For example, they may choose to continue working on a part-time basis, using part of their superannuation to supplement their employment income, instead of leaving the workforce altogether. The objective in providing greater flexibility in the rules for accessing superannuation benefits is to encourage people to retain a connection with the workforce for a longer period.⁵

The consultation paper also raised for discussion some of the unresolved details regarding the implementation of the provision. These included whether the TTR provisions should be subject to a work test so they will only be applicable to part-time workers, and whether superannuation funds should be mandated to offer their eligible members the option of an income stream that complies with the TTR provisions.⁶

Subsequently, regulations were introduced to enact the TTR provisions, with a commencement date of 1 July 2005.⁷ These regulations, which amended the *Superannuation Industry (Supervision) Regulations 1994*, allowed taxpayers who had reached preservation age but were still working to convert a portion of their superannuation funds into a non-commutable income stream. The Explanatory Statement that accompanied these regulations stated that the policy benefits of the changes were to allow older workers flexibility in transitioning to retirement, and like the initial consultation paper, gave the example of someone reducing their full-time work to part-time while accessing their superannuation to top up their reduced salary.⁸ It followed by further reiterating what was said in the consultation paper, that these regulations would increase workforce participation and contribute to economic growth, as workers would not have to completely cease their employment to access their superannuation.⁹

⁵ Ibid 3-4.

⁶ Ibid 10-11.

⁷ *Superannuation Industry (Supervision) Amendment Regulations 2005 (No. 2)*.

⁸ Explanatory Statement, Select Legislative Instrument 2005 No. 56, Retirement Savings Accounts Act 1997, Superannuation Industry (Supervision) Act 1993, 4.

⁹ Ibid 5.

The Explanatory Statement also discussed how the unresolved operational issues raised in the earlier consultation paper had been decided, as well as the basis for those decisions. Specifically, it was mentioned that a decision had been made to not make the TTR provisions subject to a part-time work test. The reasoning behind this was, first, because some people might transition to retirement by reducing their work responsibilities rather than working fewer hours.¹⁰ Secondly, there was a view that a work test would burden superannuation funds by necessitating them to check whether those using the TTR provisions had complied with such a test.¹¹

While both the initial TTR consultation paper and Explanatory Statement made it clear that the TTR provisions were intended to allow people transitioning towards retirement (whether it be by going part-time or by undertaking fewer work responsibilities) to top up their lower incomes through accessing superannuation, there was nothing to indicate they were to be used by mature workers who did not change roles or hours and so did not experience a pay reduction.

OPERATION OF THE TTR PROVISIONS

The general rule before the implementation of the TTR provisions was that, in most cases, for a taxpayer to access their superannuation they must have reached their preservation age, and if under 65, they must have ceased their employment.¹² Furthermore, if they were under 60 an added condition was that they must have intended to not be gainfully employed again.¹³ The preservation age is currently 55 years of age, though legislation is in place to incrementally raise it to 60.¹⁴ The laws in place prior to the TTR provisions meant taxpayers who had reached preservation age but were under 65 and had reduced their work hours in their job could not access their superannuation savings.

The effect of the TTR provisions is that a taxpayer who has reached preservation age but has not ceased employment can withdraw his/her superannuation in the form of a non-commutable income stream.¹⁵ In contrast, there is no such limitation for taxpayers that access their superannuation upon ceasing employment, meaning that they can do so in the form of a lump sum or income stream.

¹⁰ Ibid 5.

¹¹ Ibid 6.

¹² Ibid 2.

¹³ Ibid 2.

¹⁴ *Superannuation Industry (Supervision) Regulations 1994* ('Sis Regs') Reg 6.01.

¹⁵ Reg 6.01(2) and Sch 1 to the Sis Regs.

To a large degree the tax implications applicable to a TTR income stream are the same as those applicable to taxpayers that have ceased employment and have converted all or part of their superannuation savings into an income stream. In both instances the earnings of the underlying funds that support the income stream are tax-free,¹⁶ and, the income stream can be in the form of a phased withdrawal product or an annuity.¹⁷ Also, in both instances, there are age-based, annual minimum withdrawal percentages.¹⁸ Furthermore, in both instances, for those at least 60 years of age the receipt of the income stream is tax-free,¹⁹ and for those under 60 but at least of preservation age it is taxed at marginal rates less a 15% rebate.²⁰ However, one difference is that for a retired taxpayer there is no legislated maximum withdrawal limit of the income stream, whereas a TTR taxpayer can only annually withdraw up to 10% of the balance of the funds supporting the income stream.²¹

USE OF THE TTR PROVISIONS

As discussed, when the TTR provisions were enacted, they were aimed at older workers who wanted to transition towards retirement through going part-time, or continuing to work full-time in a role with lower responsibilities. However, it has become popular for full-time mature workers to utilise the TTR provisions as a tax minimisation tool.²² Specifically, the first step in doing so is for a taxpayer to salary sacrifice into their superannuation accumulation account up to or near the limit of their concessional contribution cap, which in isolation lessens their take home pay.²³ Using the TTR provisions they then convert part of the balance of their superannuation account into a non-commutable income stream, which they use as money to replace what they have salary sacrificed, so as to pay for day-to-day living expenses. The net effect of this arrangement, if done properly, is that there is no change to take home pay, but less tax is paid, meaning that the overall superannuation balance becomes higher than it otherwise would be without this

¹⁶ *Income Tax Assessment Act 1997* ('ITAA') s 301-10.

¹⁷ Reg 6.01(2) to the Sis Regs.

¹⁸ Sch 7 to the Sis Regs.

¹⁹ ITAA s 301-10.

²⁰ ITAA s 301-25.

²¹ Reg 6.01(2) and Sch 1 to the Sis Regs.

²² ASIC's Moneysmart website <<https://www.moneysmart.gov.au/superannuation-and-retirement/income-sources-in-retirement/income-from-super/transition-to-retirement>> states that this is a legitimate use of these provisions.

²³ While a taxpayer can salary sacrifice to a lower degree, so that their concessional contributions is nowhere near reached, this will lessen the tax benefit of such an arrangement.

arrangement.²⁴ The reason for this tax effect is two-fold. First, this technique, in essence, makes more of the taxpayer's income taxed at the concessional contribution rate of 15%²⁵ rather than the taxpayer's marginal tax rate. Secondly, earnings on funds used to support the income stream are tax free,²⁶ whereas, if the TTR provisions had not been entered into, the full superannuation money would still be in accumulation mode and earnings would be taxed at 15%.²⁷ However, as income streams for taxpayers who are under 60 years of age are taxed at their marginal rate less a 15% rebate, the net tax benefit for such taxpayers is smaller than for those who are aged at least 60 and so are subject to no tax on their income streams. It is also worth noting that as that concessional contributions cap is smaller than it was prior to 1 July 2012,²⁸ the potential tax-benefit that full-time mature workers can gain through use of the TTR provisions is not as large as it used to be.²⁹

Although it was originally feared by some that this use of the TTR provision could trigger Part IVA³⁰, the income tax legislation's general anti-avoidance provision, the ATO has since made it clear that it would not.³¹

SHOULD THE TTR PROVISIONS BE AVAILABLE FOR USE BY FULL-TIME WORKERS?

Consistency with Specific Original Aims of Legislation

As described, the initial aim of the TTR provisions was to allow those transitioning to retirement through an arrangement that offers lower pay to dip into their superannuation. This was to encourage such workers to maintain some employment, it being speculated that their only viable alternative in some cases being to cease working and enter full retirement. The resulting decrease in the workforce participation rate was seen as being suboptimal at both the individual and aggregate level.

²⁴ Jones S, *Australian Superannuation Handbook 2012-13* (2012 Thomson Reuters) 801-802.

²⁵ ITAA s 292-25 and s 295-160.

²⁶ ITAA s 301-10.

²⁷ *Income Tax Rates Act 1986* s 26(1), s 27(1) and s 27A.

²⁸ ITAA subdiv 291-B, *Income Tax (Transitional Provisions) Act 1997* s 291-20 and *Superannuation (Excess Concessional Contributions Charge) Act 2013*.

²⁹ This is because the maximum amount of money that can be salary sacrificed and replaced with a TTR income stream is lower with the smaller concessional contributions cap.

³⁰ *Income Tax Assessment Act 1936* part IVA.

³¹ See ATO, *Guidance on Transition to Retirement Pensions Media Release Nat – 2005/66* (2005) <<http://www.ato.gov.au/corporate/content.aspx?doc=/content/66276.htm>> at 10 December 2012.

In contrast, the use of the provisions as a tax minimisation tool by full-time workers who are entitled to the same pay as they were before entering a TTR arrangement does not appear to be consistent with this aim. Such workers would generally not need to use the TTR provisions to access their superannuation as they are not experiencing a lowering of their income. Consequently, it would be difficult to argue that such workers fulfil the aims of the TTR provisions that were envisioned when it was first enacted.

Consistent with the Aim of Increasing Workforce Participation

While use of the TTR provisions by full-time workers as a tax tool is inconsistent with their original specific intent, it could be argued that such a use is still broadly consistent with the over-riding intention of the TTR provision, in that such a use potentially increases participation rates amongst older workers.³² Specifically, although full-time mature workers do not require the TTR provisions to maintain their income, it could be argued that the provisions give such workers an incentive to stay in the work force, due to the lower tax burden leading to the workers benefiting from a higher superannuation balance than would otherwise be the case.³³ However, the accuracy of such a claim requires closer scrutiny.

A worker who has the option of being able to utilise the TTR provisions to effectively lessen the tax on their superannuation is subject to two opposing effects. The first is the 'substitution effect', which makes the opportunity cost of not working more expensive because of the higher after-tax superannuation one would receive from working.³⁴ Consequently, the substitution effect acts as an incentive to continue working. The counter to this is the 'income effect', where superannuation, being more concessional tax, leads to retirement goals being reached more quickly, and

³² Explanatory Statement, Select Legislative Instrument 2005 No. 56, Retirement Savings Accounts Act 1997, Superannuation Industry (Supervision) Act 1993, 4-5.

³³ See Australian Chamber of Commerce and Industry, *ACCI Response to Grey Areas – Age Barriers to Work in Commonwealth Laws Australian Law Reform Commission (ALRC) Issues Paper 41* (2012) 7-8 <http://www.alrc.gov.au/sites/default/files/pdfs/44_acci.pdf> at 14 January 2013; Australian Institute of Superannuation Trustees, *AIST Submission, ALRC – Grey Areas – Age Barriers to Work in Commonwealth Laws* (2012) 8 <http://www.alrc.gov.au/sites/default/files/pdfs/47._australian_institute_of_superannuation_trusteesalrc_grey_areas_barrier_to_work_jun_2012_final.pdf> at 14 January 2013.

³⁴ Headey B, Freebairn J and Warren D, Melbourne Institute of Applied Economic and Social Research, *Dynamics of Mature Age Workforce Participation: Policy Effects and Continuing Trends, Final Report* (2010) 53 <<http://www.melbourneinstitute.com/downloads/labour/5-10FinalReport.pdf>> at 6 December 2012.

so acts as a disincentive to continue working.³⁵ The fact that some people who had planned to retire, but as a result of the Global Financial Crisis diminishing their retirement savings, continue to be in the workplace is an example of the income effect operating in reverse.

There is some international evidence that as far as retirement savings are concerned, the substitution effect is the stronger of the two, and, consequently, a greater increase in retirement savings does increase workforce participation, albeit to a very mild extent.³⁶ However, the limited evidence suggests that the TTR provisions specifically may not have been effective in increasing workforce participation,³⁷ though the evidence is far from conclusive.

If it is assumed that the TTR provisions, as used by full-time workers, increase workforce participation, and it is assumed that this benefit exceeds the relevant fiscal cost, it does not necessarily follow that the TTR provisions should be available for full-time workers. Rather, the net benefits of their use by full-time workers should be compared with those of alternative policies that have similar goals.³⁸ Specifically, it is useful to compare the TTR provisions to other tax incentives that are aimed at increasing full-time mature worker participation.

Increasing Mature Worker Participation Rates through Lower Superannuation Taxation

To the extent that there is a goal of increasing the workforce participation rate amongst older workers by giving them a tax break on their superannuation, there are fairer, more direct ways to achieve this. Specifically, the government could lower the

³⁵ Ibid.

³⁶ Brown K, 'The Link between Pensions and Retirement Timing: Lessons from California Teachers' (2013) 98 *Journal of Public Economics* 1.

³⁷ Headey et al., above n 34, 84. However, this only concerns data between 2005-2007, and so did not examine the effect that the TTR provisions had on participation rates after the major changes that were made to the superannuation system in 2007. See also ALRC, *Access All Ages—Older Workers and Commonwealth Laws*, above n 1, 209-10, stating that some have suggested that the reason that this study did not find increased participation rates was due to positive economic conditions at the time giving people a greater ability to enter early retirement.

³⁸ There is a very wide range of policies aimed at increasing mature worker participation rates that can be implemented by governments. The potential policies include possibilities such as implementing awareness campaigns and targeted training subsidies. A consideration of which mix of all these potential policies has the largest net benefit is a highly complex subject and beyond the scope of this article. The analysis here is confined to comparing the TTR provisions to other similar policies.

superannuation contributions tax rate or earnings tax rate for mature workers. This would have a few advantages over the use of TTR provisions by full-time workers to effectively lower their superannuation taxation. First, it would allow all mature full-time workers to benefit from such tax incentives. In contrast, the TTR provisions only allow a subset of mature workers to benefit. This is due to the fact that for someone to materially benefit from the TTR provisions they need to have a reasonably sized superannuation balance. The need for an adequate sized balance is related to the TTR provisions allowing a maximum of 10% of the funds supporting the non-commutable income stream to be distributed in any given year.³⁹ As higher income earners are more likely to have higher superannuation balances, the availability of the TTR provisions is to some extent skewed towards higher income earners. Consequently, looked at in isolation, the TTR provisions appear broadly regressive in nature, though admittedly this needs to be seen in the context of a tax system that is still, overall, progressive.⁴⁰ Secondly, for full-time workers to use the TTR provisions to effectively lower their tax burden, they need to have an employer who is willing to allow them to salary sacrifice higher amounts into superannuation, which, while common, is not always the case.⁴¹ A related issue is that many mature full-time workers do not use the TTR provisions because they do not have the knowledge, inclination or motivation to set up an arrangement to use them.⁴²

The specific fiscal cost of lowering superannuation tax rates for mature workers would be dependent on the magnitude of the reduction granted to them. It would be possible for the cost of the current TTR provisions per full time worker that utilises them to be estimated,⁴³ and the precise size of the lower superannuation tax rates for

³⁹ Reg 6.01(2) to the Sis Regs.

⁴⁰ Rothman G, Retirement & Intergenerational Modelling & Analysis Unit - Department of the Treasury, *Assessing the Equity of Australia's Retirement Income System* (2009) 16 <<http://www.asb.unsw.edu.au/research/cps/Documents/G.%20Rothman%20-%20Assessing%20the%20equity%20of%20Australia%E2%80%99s%20retirement%20income%20system%20.pdf>> at 17 December 2012.

⁴¹ Commonwealth of Australia, *Australia's Future Tax System: the Retirement Income System: Report on Strategic Issues* (2009) 30 <http://www.taxreview.treasury.gov.au/content/downloads/retirement_income_report_strategic_issues/retirement_income_report_20090515.pdf> at 14 January 2013.

⁴² See Walter MM, Jackson N and Felmingham BS, 'Keeping Australia's Older Workers in the Labour Force. A Policy Perspective' (2008) 43(2) *Australian Journal of Social Issues* 291, 299, where survey data indicate that a sizeable proportion of workers lack an awareness of TTR provisions.

⁴³ Recent Budget Papers and Tax Expenditure Statements do not contain specific estimates of the fiscal cost of the TTR provisions.

mature workers tailored so that they have a similar average fiscal cost per mature worker. While the ability of more workers to use these hypothetical provisions would lead to such provisions having a greater aggregate fiscal cost, this cannot be considered a bad outcome if it is assumed that there is a net overall benefit per full-time mature worker who utilises the TTR provisions. Alternatively, a smaller cut to the mature worker superannuation tax rate, one that would have a lower cost per mature worker than the TTR provisions have per worker that uses them, could be introduced if it is considered that this would give a better trade-off between fiscal cost and benefit. Indeed, it would be a strange coincidence if such a concession, set at the rate that gave the ideal net benefit, would grant the same monetary benefit per mature worker as the TTR provisions do to full-time workers that use them. Such a policy could also be subject to means testing so as to restrict its total fiscal cost.

Comparison of Tax Benefit Aimed at Mature Workers' Superannuation to Tax Benefit Aimed at Mature Workers' Salary

While, as far as encouraging participation rates is concerned, a larger tax concession on mature workers' superannuation has advantages over mature workers being allowed to utilise the TTR provisions so as to indirectly lessen their superannuation taxation, a broader issue is whether an even better solution would be to lower the income salary tax payable by mature workers.⁴⁴ There is evidence that lower income taxes on salaries have a substantially stronger effect on work incentive for mature workers than younger cohorts.⁴⁵

A good starting point is to examine the justifications for concessionally taxing superannuation, so as to decide whether those justifications are more applicable to older workers. If they are, this strengthens the case of a lower mature worker

⁴⁴ While the TTR provisions could be used by full-time workers in a way that leads to most of the tax benefits increasing their take home pay rather than increasing their net superannuation balances, as far as full-time workers are concerned, they are generally promoted to be used in a manner that increases superannuation savings rather than take home pay.

⁴⁵ See French E, 'The Effects of Health, Wealth, and Wages on Labour Supply and Retirement Behaviour', 72 *Review of Economic Studies* (2005) 395, 396 which used modelling calibrated against data from the Panel Study of Income Dynamics and found that labour market elasticity markedly increased as workers reached retirement age. This was due to the ability of such workers to access Social Security and pension benefits. In Hemel D, 'Should Tax Rates Decline with Age?' (2011) 120 *Yale Law Journal* 1885 the authors make the point that lower income taxes on mature workers are consistent with the broader principle of inelastic supplies being subject to comparatively higher rates of taxation and vice-versa.

superannuation tax over a lower mature worker salary tax. The Henry Review said the following:

Superannuation is the main form of lifetime saving outside the family home. There is a bias in the current taxation system against long-term saving, particularly lifetime saving such as superannuation. There are at least two reasons for taxing superannuation more favourably than other saving (with the exception of housing) to reduce this bias.

The first reason is that taxing superannuation earnings, like the earnings on most forms of savings, means that the effective rate of tax on the real value of saving increases the longer an asset is held (see Section A1 Personal income tax). This effect is more pronounced in superannuation than other savings as superannuation saving is generally held for a longer time. This justifies a more favourable tax treatment.

The second reason is that superannuation is a form of deferred income. People should be taxed on superannuation at the rate that would apply if their income had been spread over their entire life rather than merely over their working life. This is an income-smoothing argument. As a person's retirement income is generally lower than their income while they were working, it should be taxed at a lower rate.⁴⁶

None of these justifications for superannuation tax concessions are more applicable to mature workers. Specifically, the concessions being there as a means to prevent the after-inflation returns of retirement savings being excessively taxed is a reason that is not any more applicable to mature workers than other workers. Furthermore, the desire to tax retirement savings at a lower rate to account for the fact that taxpayers' future retirement income will be lower is not any more relevant to mature full-time workers over younger cohorts.

An important consideration when comparing the merits of a tax incentive on mature workers' salary to lower taxes on their superannuation is that there is reason to believe that the former has a greater effect on their work incentive and so would have a greater effect on increasing the participation rate of mature workers. It has been suggested that for the general workforce, the work incentive effect for every extra dollar in superannuation is only approximately 50% as powerful as the work

⁴⁶ Commonwealth of Australia, *Australia's Future Tax System – Final Report: Part 2 Volume 1* (2010) 96-7 <http://taxreview.treasury.gov.au/content/downloads/final_report_part_2/AFTS_Final_Report_Part_2_Vol_1_Consolidated.pdf> at 10 December 2012.

incentive effect that lies with every extra dollar in salary.⁴⁷ Certainly, the evidence supporting the work incentive effect of lower salary taxes, especially when compared to the evidence regarding the work incentive effect of lower retirement savings taxes, is highly comprehensive.⁴⁸ While it is logical that the closer a worker is to full retirement and being able to fully access the superannuation, the less difference there is in the incentive effect of these two choices, there is some limited evidence indicating that as far as mature workers are concerned, lower salary taxes would have a substantially stronger work incentive effect than the lowering of superannuation taxes.⁴⁹

Another important consideration when deciding between such policies is their net fiscal cost. On the one hand, it is logical that dollar-for-dollar of lost tax revenue, a lower superannuation tax rate for mature workers has a smaller long-term fiscal cost when compared to a lower salary tax rate. This is because a superannuation tax cut can be assumed to have a greater impact on boosting retirement savings than a salary tax cut, and so will lead to a comparatively greater saving on future pensions; a superannuation tax cut will still however have a net long-term fiscal cost.⁵⁰ The difference between the two options in boosting retirement savings would to some extent be diminished the closer the worker is to retirement given that such a worker would more readily substitute salary and retirement savings in achieving their

⁴⁷ Guest R and MacDonald I, 'Superannuation, Population Ageing and Living Standards in Australia' (2002) 32(1) *Economic Analysis and Policy* 19, 30. However, note that this estimate is not based on empirical evidence.

⁴⁸ See Evers M, De Mooij R and Vuuren D, 'The Wage Elasticity of Labour Supply: A Synthesis of Empirical Estimates' (2008) 156 *De Economist* 25, where a meta-analysis of a wide range of data shows that lower taxes do provide an incentive to work, though this incentive effect is much stronger for women than men.

⁴⁹ The estimated wage elasticity of labour supply of mature workers is substantially higher in French, above n 45, as compared to the elasticity of labour supply of mature workers in response to higher retirement benefits in Brown, above n 36.

⁵⁰ Superannuation tax concessions have a net fiscal cost because the tax expenditure from the current superannuation tax concessions outweighs future pension savings: Institute of Actuaries of Australia, *Australia's Future Tax System Draft Submission from the Institute of Actuaries of Australia Retirement Income Consultation Paper* (2009) 13 <http://www.taxreview.treasury.gov.au/content/submissions/retirement/Institute_of_Actuaries_of_Australia_20090312.pdf> at 11 December 2012; see also Report on Strategic Issues, above n 41, where it is projected that an increase in the superannuation levy will lead to a net fiscal cost in the long-term. It is logical that any increase in superannuation tax concessions would lead to an increase in net fiscal cost.

retirement goals.⁵¹ On the other hand, the fact that lower taxes on salary income have a comparatively greater incentive effect as compared to lower superannuation taxes means that less of a salary tax cut would be required for a similar incentive effect. For instance, using hypothetical figures that do not necessarily accurately reflect the precise difference in incentive effects, a \$100 a week salary tax cut might give a similar incentive effect to a \$150 a week superannuation tax cut. This means that the net fiscal cost of a salary tax cut might end up being smaller than the fiscal cost of a superannuation tax cut for a given increase in mature workforce participation, though this is an area that would benefit from further research.

Overall, there does appear to be competing cases regarding the comparative merits of a superannuation or salary tax cut for older workers. Importantly, if the latter option is chosen, such a policy would have to be formulated correctly to have the desired effect. Specifically, such a policy would have to be implemented in a manner that has substantive differences to the Mature Age Worker Tax Offset. The Mature Age Worker Tax Offset is a means tested rebate that applies to workers who are at least 55 years of age and gives them a rebate of up to \$500 a year.⁵² However, this offset is now being phased out, and, as of 1 July 2012, is only potentially available to taxpayers born on or before 30 June 1957.⁵³ Although the 2012 Budget and the relevant Explanatory Memorandum did not state the precise reason for its gradual withdrawal,⁵⁴ the 2010 Henry Review did recommend its abolition on the basis that it was uncertain whether it increased participation rates, and that higher tax-free thresholds for all are a superior method of encouraging workforce participation.⁵⁵ Relevant interest groups have stated that when in force, it provided almost no

⁵¹ To the extent a worker is nearing retirement, if they feel their retirement savings are insufficient, extra salary income is more likely to find its way to their retirement savings, whether this be through extra superannuation contributions or savings outside of superannuation. Conversely, for a worker that is close to retirement who feels that their retirement savings are roughly adequate, an increase in the net amount added to their retirement savings is more likely to lead to less voluntary contributions to their retirement savings or less paying off of personal debt.

⁵² ITAA subdiv 61-K.

⁵³ ITAA s 61-560.

⁵⁴ Paragraph 2.5 of the Explanatory Memorandum of Laws Amendment (2012 Measures No. 5) Bill 2012 describes this as a 'high cost' method of keeping mature workers in the workforce though does not elaborate on this comment. Australian Government, *Budget 2012–13: Budget Paper No. 2* (2012) 37 <http://www.budget.gov.au/2012-13/content/bp2/download/bp2_consolidated.pdf> at 10 December 2012 also does not explain why it was abolished, though does state the saved funds will be redirected to other programs aimed at assisting mature workers.

⁵⁵ Australia's Future Tax System, above n 46, 35, 87.

incentive for mature workers to stay in the workforce.⁵⁶ Specifically, these groups expressed the belief that its ineffectiveness was a result of its relatively small size, together with the fact that it was paid in the form of a rebate that was only claimable at the end of a financial year.⁵⁷ Subsequently, any income tax concessions aimed at increasing mature worker participation should result in them receiving a larger regular take home pay, and should be of sufficient size to give them a material extra work incentive.

TTR Provisions To Allow Older Workers to Build up Their Superannuation

Opportunities for mature workers to build up their superannuation balances are typically limited due to their proximity to retirement. Consequently, it has been argued that the availability of the TTR provisions to full-time workers is a taxpayer-funded way of assisting them to build up their superannuation balances.⁵⁸ This argument is bolstered by the fact that compulsory superannuation only began in 1992, with an initial compulsory contributions rate set at a modest 3%, meaning that older workers have had limited opportunities to benefit from a mature superannuation system than younger cohorts of workers.⁵⁹

While it is beyond the scope of this article to discuss whether government policy should encourage higher superannuation balances amongst mature workers,⁶⁰ if it is assumed that this is a desirable outcome, there are preferable policy options to achieve this goal as compared to allowing the TTR provisions to be used by full-time workers. A major negative of allowing the TTR provisions to be used for encouraging higher superannuation balances arises from the fact that, as discussed earlier in this paper, the provisions are, generally, more likely to be used by those who have larger superannuation balances to begin with. Consequently, full-time mature workers who

⁵⁶ Australian Law Reform Commission, *Age Barriers to Work — Discussion Paper* (2012) 155 <http://www.alrc.gov.au/sites/default/files/pdfs/publications/whole_78_0.pdf> at 9 August 2013.

⁵⁷ Ibid.

⁵⁸ See Australian Institute of Superannuation Trustees, *AIST Submission, ALRC – Grey Areas – Age Barriers to Work in Commonwealth Laws* (2012) 8 <http://www.alrc.gov.au/sites/default/files/pdfs/47._australian_institute_of_superannuation_trusteesalrc_grey_are_as_barrier_to_work_jun_2012_final.pdf> at 14 January 2013.

⁵⁹ For a history of the superannuation system, see APRA, *A Recent History of Superannuation in Australia* (2007) <<http://www.apra.gov.au/Insight/documents/History-of-superannuation.pdf>> at 10 December 2012.

⁶⁰ Although all things constant, higher superannuation balances are advantageous, policies that encourage higher balances will invariably have some down sides, such as a net loss of government revenue.

benefit from an increase in their superannuation balances through using the TTR provisions are, in many cases, those who least require it. In comparison, implementing the abovementioned policy of comparatively lower tax on superannuation for all mature workers would be a preferable policy approach, as it would encourage higher superannuation balances in a more widespread and equitable manner. Such a policy would be more likely to moderate the perception held by many workers of a lower socio-economic status that they have been unfairly treated due to the comparatively recent maturity of the superannuation system.⁶¹ While such a policy would be utilised by more workers and so have a higher fiscal cost, if it is assumed that use of the TTR provisions by full time workers brings a net benefit per worker that attains a higher superannuation balance, then the overall result from a more widely available mature worker superannuation tax concession would be of a larger net benefit.

However, an even more preferable way of encouraging higher mature worker superannuation balances is by increasing the concessional contribution caps for such workers. Prior to 1 July 2012, the concessional contribution cap was \$50,000 for taxpayers of at least 50 years of age, and \$25,000 for younger taxpayers, but, from 1 July 2012, it was set at \$25,000 for all eligible age groups.⁶² It was originally government policy that, from 1 July 2012, the higher \$50,000 cap for taxpayers of at least 50 years of age would continue, subject to the new condition of their having a superannuation account balance of less than \$500,000.⁶³ However, the government later announced that this policy would be deferred until 1 July 2014 and that from 1 July 2012 till then the \$25,000 cap would apply to all age groups.⁶⁴ The government then once again changed its mind by announcing that from 1 July 2013, there would be an increased cap of \$35,000 for those at least 60 years of age, and that the \$35,000

⁶¹ Quine S, Bernard D and Kendig H, 'Understanding Baby Boomers' Expectations and Plans for their Retirement: Findings from a Qualitative Study' (2006) 25(3) *Australasian Journal on Ageing* 145, 148.

⁶² ITAA subdiv 292-B, repealed by Tax Laws Amendment (Fairer Taxation of Excess Concessional Contributions) Act 2013.

⁶³ Commonwealth of Australia, *Fact Sheet: Superannuation – Concessional Contributions Caps* (2011) <http://www.futuretax.gov.au/content/Content.aspx?doc=FactSheets/concessional_contributions_caps.htm> at 10 December 2012.

⁶⁴ Australian Government, *Budget 2012–13: Budget Paper No. 2* (2012) 40 <http://www.budget.gov.au/2012-13/content/bp2/download/bp2_consolidated.pdf> at 10 December 2012.

cap would, from 1 July 2014, also apply to those who are at least 50 years old.⁶⁵ Although the announcement did not explicitly refer to the previous plan to increase the cap to \$50,000, it was clear that the increase to \$35,000 was in substitute of this previous proposal.⁶⁶ Furthermore, it was announced that this new higher cap was not to be subject to taxpayers having a superannuation balance of less than \$500,000, as the government was persuaded by feedback from the superannuation industry that such a requirement would be difficult to administer.⁶⁷ This new policy has now been legislated.⁶⁸

As the current cohort of mature workers have substantially smaller median superannuation balances when compared to the projected balances of future generations of such workers,⁶⁹ further increasing the concessional contributions cap for mature workers beyond \$35,000 would give them an increased opportunity to play catch-up and make higher superannuation contributions. Objections against higher caps for older workers are generally based on them being disproportionately used by higher income earners.⁷⁰ However, their eligibility being dependent on a maximum superannuation balance would, to some extent, alleviate such concerns. And while giving superannuation funds the responsibility of limiting a higher cap to taxpayers that have a superannuation balance below a certain size would likely cause them administrative difficulties, this problem could be avoided if the onus of complying with such a test was instead placed on the individual taxpayer. The argument that the responsibility of complying with such a test should lie with the individual is strengthened by the fact that as of 1 July 2013, taxpayers that mistakenly breach the concessional contribution cap for any reason are not subject to a harsh penalty, but rather allowed to be put in the same position as if they had not made excessive contributions.⁷¹

An increased concessional contribution cap for mature workers would certainly be a fairer and more targeted way of encouraging higher balances than approaches that directly or indirectly grant mature workers a lower tax rate than the rest of the

⁶⁵ Bill Shorten, *Reforms to Make the Superannuation System Fairer* <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2013/020.htm&pageID=003&min=brs&Year=&DocType>> at 8 August 2013.

⁶⁶ *Ibid.*

⁶⁷ *Ibid.*

⁶⁸ *Income Tax (Transitional Provisions) Act 1997* s 291-20.

⁶⁹ Australian Government, *Budget 2012–13: Budget Paper No. 1, Statement 4* (2012) 4-8. <<http://www.budget.gov.au/2012-13/content/bp1/download/bp1.pdf>> at 10 August 2013.

⁷⁰ *Ibid.* 178-9.

⁷¹ ITAA subdiv 291-B, *Taxation Administration Act 1953* sch 1subdiv 96-A and *Superannuation (Excess Concessional Contributions Charge) Act 2013*.

population. Specifically, while increasing the concessional contribution cap, which is there for the purpose of limiting superannuation being used for the purpose of tax-minimisation scheme,⁷² would have some fiscal cost, a higher contribution cap would have a lower fiscal cost for a given increase in superannuation balances compared to policies that directly or effectively lower tax on mature workers' superannuation. This is because a lower mature worker superannuation tax rate results in much of the burden of the higher balance being left to the taxpaying public, whereas a higher concessional cap would distribute the burden more equally between the taxpaying community and the mature worker. Further, it would share the tax burden in a manner that resembles what would have occurred had the older workers spent a greater part of their working lives under a mature superannuation system.

SHOULD THE TTR PROVISIONS BE AVAILABLE FOR USE BY PART-TIME WORKERS?

While the case for the TTR provisions to be available for full-time workers lacks force, it is worthwhile considering whether the provisions should be usable by part-time mature workers. As discussed, such use would be consistent with their original intention of enabling more workers to transition to retirement through working part-time and using their superannuation to top up their lower incomes.

There is international evidence that a sizeable proportion of workers would appreciate the opportunity to work part-time prior to entering full retirement.⁷³ There are several advantages to workers transitioning to retirement. From society's point of view there will be economic gains to the extent that the working lives of a material number of workers are increased due to the availability to transition to retirement. It has been argued that this is particularly important in the context of an ageing population.⁷⁴ Further, to the extent that workers are extending their working lives and utilising the TTR provisions, they will individually benefit by having more money in retirement. This is because although a part-time worker utilising a TTR

⁷² ALRC, *Age Barriers to Work — Discussion Paper*, above n 56, 177.

⁷³ AARP, *Profit from Experience Perspectives of Employers, Workers and Policymakers in the G7 Countries on Demographic Realities* (2007) 74
 <http://assets.aarp.org/rgcenter/econ/intl_older_worker.pdf> at 12 December 2012 shows the findings of an international on-line survey, where a substantial percentage of workers expressed their preference to work part-time for their current or other employer as a way of transitioning to retirement.

⁷⁴ Commonwealth of Australia, *Intergenerational Report 2010* (2010) 26-30,
 <http://archive.treasury.gov.au/igr/igr2010/report/pdf/IGR_2010.pdf> at 12 December 2012.

arrangement would deplete their superannuation balance, they would not do so to the extent of someone in full retirement, since they are still earning a salary, and also because they are mandated to have their superannuation benefits paid in the form of an income stream. It has also been argued that the advantages of a staggered transition to retirement go beyond the purely financial. Specifically, it has been claimed that going part-time before ceasing work helps people avoid the emotional and life-style shock that potentially occurs when abruptly changing from full-time work to retirement.⁷⁵ This is related to the Atchely step-based model of retirement, a model that has some evidentiary support.⁷⁶ Under this model, retirement begins with the honeymoon stage, followed by disappointment in the disenchantment stage, then followed by adaptation to retirement in the reorientation stage, which then leads to the stability stage, where people have adjusted to their retirement, lastly followed by declining health leading to loss of independence, which is known as the termination stage.⁷⁷ In theory, a staggered retirement might help abate the unpleasantness of transitioning through some of these stages. Research has shown that there is some merit in this view, with a finding that health is positively correlated with a transitional as opposed to a sudden retirement.⁷⁸ However, the same research indicated that transitional retirement did not directly affect other measures of well-being, those measures being changes in life satisfaction, marital cohesion and self-image.⁷⁹ Importantly this research did also find that control over the manner in which someone retires does affect his or her retirement well-being.⁸⁰ In summary, a transitional retirement is associated with positive health outcomes, and the ability to choose how one transitions to retirement is associated with a broader range of measures of well-being. On a related note, there is separate research indicating that

⁷⁵ NSW Ministerial Advisory Committee on Ageing, *Work and Older People Roundtable Discussion Report* (2009) 7
<http://www.nsw.ipaa.org.au/content/docs/Work%20and%20Older%20People%20Report_Low%20res.pdf> at 7 December 2012.

⁷⁶ Reitzes DC and Mutran EJ, 'The Transition to Retirement: Stages and Factors that Influence Retirement Adjustment' (2004) 59(1) *International Journal of Aging and Human Development* 63.

⁷⁷ Ibid 65.

⁷⁸ De Vaus D, Wells Y, Kendig H and Quine S, 'Does Gradual Retirement Have Better Outcomes Than Abrupt Retirement? Results from an Australian Panel Study' (2007) 27(5) *Ageing and Society* 667.

⁷⁹ Ibid 674. Although those who had retired gradually had shown less satisfaction with their retirement than those who had retired abruptly, this effect did not persist for long.

⁸⁰ Ibid 675.

part-time older workers enjoyed their work substantially more than full-time older workers.⁸¹

In reality, however, there are limits to the benefits provided through the availability of the TTR provisions by mature part-time workers. First, it would appear that the opportunity for workers to work part-time for the latter part of their working lives is scarcer than would ideally be the case.⁸² However, this in itself should not preclude the use of the provisions by those who do have such an opportunity. Secondly, to the extent that workers are able to transition by going part-time, there is some equivocal evidence that this is more likely to turn their full-time work to part-time work rather than extend their working lives.⁸³ To the extent that this is true, this means that the TTR provisions, by enabling mature workers to work part-time, actually decrease the total number of hours worked by older workers, meaning that their net economic effect would be negative. On the other hand, this in itself does not lead to the conclusion that the provisions should be unavailable for mature part-time workers, given the non-financial benefits that being able to choose to transition to retirement can bring.

Overall, while it is unclear as to what extent, if any, the TTR provisions being available to mature part-time workers influences participation rates, there is a strong case for their availability for such workers, given the positive impact that the ability to transition to retirement can have on their well-being. Further, use of the TTR provisions for such workers is justified as being consistent with the aims of the superannuation regime, as one of the major aims of retirement saving regimes, such as superannuation, is to smooth one's income over one's lifetime.⁸⁴ It follows that the ability of a mature worker to dip into their superannuation upon reaching a stage in life where they wish to work less is consistent with such aims.

REFORM SUGGESTIONS

There are convincing reasons why the TTR provisions should not be available for full-time mature workers. In contrast, there is good reason to allow part-time mature

⁸¹ Quine et al., above n 61, 147.

⁸² Advisory Committee on Ageing, above n 75, 25.

⁸³ Walter et al., above n 42, 300. Headey et al., above n 34, 84 discusses findings indicating that the TTR provisions have not increased mature worker participation, though as discussed earlier, this research is subject to significant limitations.

⁸⁴ Holzmann R, Hinz RP and Dorfman M, *Pension Systems and Reform Conceptual Framework* (2008) 7 World Bank SP Discussion Paper 0824 <<http://siteresources.worldbank.org/SOCIALPROTECTION/Resources/SP-Discussion-papers/Pensions-DP/0824.pdf>> at 28 December 2012.

workers to utilise them. Consequently, there is a strong argument for policy reform that limits their use. In addition, the alternative policies discussed in this paper should be given consideration if the government wishes to increase mature worker participation through tax incentives and if it wants to encourage higher superannuation balances for mature workers.

One way for the government to stop the TTR provisions being used in a manner that is contrary to their original intention would be to start attacking use of the TTR provisions by full-time workers under Part IVA, the general anti-avoidance provision of the income tax legislation.⁸⁵ However, given that the government has announced that it will not utilise Part IVA in such a way,⁸⁶ such an about face in policy would require clear communication and ample time for taxpayers to change their current arrangements. Additionally, given the vagueness of Part IVA, and the fact that it is ultimately up to the courts if and when it applies, there is no guarantee that it would be effective in stopping use of the TTR provisions by full-time workers.

On the other hand, suitable legislative amendments could restrict the availability of the TTR provisions to part-time workers. Such amendments could achieve this end in a more certain and consistent manner compared to the attempted use of the Part IVA provisions.

The most obvious form for such legislative amendments would be to make the use of TTR provisions subject to a work test so that only taxpayers who are working part-time can use them. As discussed, this option was initially floated when the TTR provisions were being implemented but was eventually rejected. One of the reasons for the rejection was due to a view that such a test would place an unfair compliance burden on superannuation income stream providers.⁸⁷ However, in reality, the legislative provisions introducing a TTR work test could place the burden of compliance on the mature workers seeking to use the TTR provisions. This is consistent with the self-assessment nature of much of the Australian income tax regime. Furthermore, in the field of superannuation, the burden of compliance of some of the existing relevant tests falls with the taxpayer. For instance, it is up to taxpayers to ensure that they have not breached their contribution caps.⁸⁸ It could,

⁸⁵ *Income Tax Assessment Act 1936* Part IVA.

⁸⁶ ATO, Guidance on transition to retirement pensions, Media Release Nat – 2005/66 (2005).

⁸⁷ Explanatory Statement, Select Legislative Instrument 2005 No. 56, Retirement Savings Accounts Act 1997, Superannuation Industry (Supervision) Act 1993, 6.

⁸⁸ ITAA subdiv291-B, 292-C and *Superannuation (Excess Concessional Contributions Charge) Act 2013*. Admittedly, there is a difference regarding the Australian Taxation Office finding out about breaches of the contributions caps and breaches of a work test of this nature, given that it would be easier to obtain information regarding contribution

however, be argued that in practice, the burden of compliance with any TTR work test should rest with the superannuation funds, because they are concerned with the release of superannuation money, a very important responsibility whose non-compliance could betray the goals of the superannuation system. However, legislative penalties aside, the negative consequences of the release of funds through improper use of the TTR provisions are of a limited nature because the amount of funds being withdrawn is subject to an annual cap of 10% of the fund's balance.⁸⁹

Another of the justifications for not making the TTR provisions dependent on a work test was that it would be unfair on workers who wish to legitimately use the TTR provisions through taking on work activities that have less responsibility and pay, rather than through lower hours.⁹⁰ While, in theory, a work test would preclude such taxpayers from using the TTR provisions, the evidence indicates that seeking to use the TTR provisions in such a manner is uncommon.⁹¹ Consequently, while the TTR provisions being subject to a part-time work test could lead to a small number of mature workers who would like to continue to work full-time in a lower-paid role being unable to do so, the rare instances where this potentially occurs are outweighed by the substantial policy justifications of having such a work test.

CONCLUSION

The use of the TTR provisions by full-time workers to reduce tax is inconsistent with their original intention. While it is claimed that such use of these provisions is justified because they assist the fulfilment of certain policy goals, it is unclear whether they fulfil such goals in a meaningful way. Further, there are alternative policies that are more suitable in fulfilling these goals. Specifically, to the extent that policy makers wish to attempt to increase participation rates through a tax break for mature workers, consideration should be given to lowering the tax rate applicable to the superannuation or wages of such workers. Further, if higher mature worker superannuation balances are seen as desirable, then thought should be given to increasing the concessional contribution cap of mature workers. Clearly, the potential

amounts from superannuation funds as compared to information regarding working hours from employers.

⁸⁹ Reg 6.01(2) and Sch 1 to the Sis Regs.

⁹⁰ Explanatory Statement, Select Legislative Instrument 2005 No. 56, Retirement Savings Accounts Act 1997, Superannuation Industry (Supervision) Act 1993, 5.

⁹¹ AARP, above n 73, 74 shows that, internationally, a much greater proportion of mature workers intend to work part-time as a transition to retirement then continue in a different full-time role.

positive outcomes of these policies need to be balanced against their fiscal cost, though this cost could be abated by means testing their availability.

In contrast, there is good policy reason to allow the TTR provisions to be used by mature part-time workers who need access to their superannuation funds for day-to-day living costs. This is the case even if allowing such a use does not increase participation rates. Consequently, serious consideration should be given to enacting legislation that makes the TTR provisions subject to a work test so that their use is restricted to part-time workers. Such a test would help ensure that taxpayers that use these provisions are from a policy perspective justified in doing so.