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Atax UNSW

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A comparative analysis of Australian and Hong Kong retirement systems

Christopher Strano[1] and Dale Pinto[2]

Abstract

In the developed world, there comes a point in a person's life when it is socially accepted that they should no longer be required to earn an income through personal exertion — generally quantitatively determined by their age.

The level of support an older person receives is often correlated with the economic stability of the jurisdiction in which they reside. This support can range from basic services through to modest level pensions and healthcare. All support is funded by

1. INTRODUCTION

The World Bank has played an integral part in worldwide pension systems over the past 30 years. The major focus initially was on social security support for older people, which became an issue predominately due to a global aging population. However, this issue was exacerbated by deficiencies in traditional government and employment-linked retirement plans, as well as changing work patterns resulting in a lack of job stability, and local and international labour migration. A weakening of communities and family-based arrangements also contributed.[7]

The World Bank's experience led them into research on what was quickly becoming an old age crisis by the mid-1990s; subsequently releasing a report, *Averting the Old Age Crisis*. Their agenda was a focus on the refinement of pension systems, by establishing key principles and concepts, to accommodate diverse populations and mitigate the financial risks associated with the older generation.[8]

The World Bank identified that the expected significant growth in individuals over age 60 around the world would put major strains on global healthcare and financial security. They noted that the economic affect was not restricted to older people, but extended to all age groups. While the growth in population and ensuing economic stresses was anticipated to be greater in developing countries, particularly Asia and specifically China, developed countries faced the same problems.[9]

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The World Bank's involvement in pension systems didn't stop there. In 2005, they released a report, *Old Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform*. Through involvement with policy makers and pension experts during implementation of pension reform, this 2005 report extended the three-pillar system to a five-pillar system. The addition of a zero, basic, pillar to deal more explicitly with the poverty objective and a non-financial fourth-pillar consisting of access to support and social programs, healthcare and housing. This inclusion of both a zero and a fourth pillar did not result from flaws in the three-pillar approach, but rather to further strengthen the overall pension framework.[11]

Ultimately, the World Bank has made it clear that the five-pillar pension system should be utilised as a benchmark, not a blueprint. The experience of the World Bank and its intimate involvement in pension reform has identified widely varied circumstances across numerous jurisdictions around the world. It recognises many differing starting points, objectives and economic circumstances. For this reason, the five-pillar system has intentionally been created as a flexible benchmark and guide for pension reform, rather than a prescriptive model that would define or limit possible alternatives.[12]

When the World Bank's first report was released in the mid-90s, recommending a three-pillar pension system, Hong Kong's pension system already consisted of two of the three pillars: a social security scheme and a voluntary personal savings plan. Consideration was given to Hong Kong's population and savings habits and, seeing it as a good fit, they immediately began the process of implementation of the third pillar — a mandatory employment-related contribution system — The Mandatory Provident Fund system, which began operation in December 2000.[13] Hong Kong's current

2. COMPARING AUSTRALIA AND HONG KONG AGAINST THE WORLD BANK CONCEPTUAL FRAMEWORK

The first pillar, the non-contributory 'Zero Pillar', has the primary objective of alleviating poverty. It achieves a minimal level of protection for the elderly by providing basic income support. Non-contributory refers to the fact that eligibility for old age pension payments is not determined by any form of pre-retirement contributions made by the recipient. Instead, the Zero Pillar is structured to support residents with low lifetime incomes, including those with limited participation in the formal economy.[19]

Hong Kong has three non-contributory Zero Pillar social security income support payments to older residents. The first is the *Comprehensive Social Security Assistance (CSSA) Scheme*, a means tested payment of up to HK$3,200 per month providing

eligible for the part-age pension (and some DVA pensions); specifically those with a

As with Hong Kong, Australia does not have an equivalent to the World Bank's mandatory First Pillar. It too has built its retirement system around the remaining four of the five pillars. Defined benefit plans funded through mandatory contributions are ingrained in Australia's retirement system; however, such plans are being phased out with a preference for individual retirement savings accounts. Irrespective of this, Australia's defined benefit plans are industry-sector specific rather than all-inclusive as intended by the First Pillar World Bank framework. [30]

2.2 A mandatory Second Pillar

expenses. Such plans afford maximum predictability, yet are said to be unsustainable and unaffordable for their sponsors.[35]

At the other end of the spectrum, defined contribution plans are concerned with accumulating a capital investment amount intended on delivering an income stream throughout retirement. This method moves away from the retirement income approach towards a capital accumulation approach, whereby the member bears all the investment risk, pre- and post-retirement, in an area in which they are no doubt unskilled; then they are expected to manage the addition of longevity risk using the net present value theory.[36]

Second Pillar defined contribution plans are becoming an increasingly integral part of overall retirement plans worldwide. For some countries, defined contribution plans are the main pillar. Therefore, the importance in the adequacy of these plans and benefits stemming from them should not be understated.[37]

In Australia, as at February 2014, approximately 83 percent of retirement benefits, based on asset values, were held in defined contribution plans, with the remainder in defined benefit plans.[38] In Hong Kong, approximately 86 percent of retirement benefits were held in defined contribution plans as of 31 March 2014.[39, 40]

Australia's Superannuation Guarantee (SG) System is the main component of Australia's defined contribution pension plan, requiring employers to contribute a percentage of an employee's salary to their superannuation account on a quarterly basis. The current rate is at 9.5 percent. This rate is progressively increasing from 9.0 percent to 12.0 percent between the 30 June 2013 and 1 July 2022.[41] While initially intended to supplement the age pension, this increase in mandatory contributions is now transforming the perception of superannuation into a total retirement income solution.[42]

Hong Kong's defined contribution pension plan is built around the Mandatory Provident Fund (MPF) System. Generally, an employee and their employer are both obligated to each contribuysrally2 c.338<00018.3004C>6<005605l0003>y2 .338<00018.30ined

and was specifically established as Pillar Two under the World Bank's five-pillar retirement protection approach.[45]

One noticeable difference between Australia and Hong Kong's mandatory contribution system is that non-employees (i.e. self-employed persons) in Australia are not obligated to make mandatory contributions into superannuation on their own behalf. In fact, they're not even required to have a retirement account.[46] In Hong Kong, self-employed persons must contribute five percent of their own income into their retirement plan.[47]

2.3 A voluntary ‗Third Pillar' ¶

A voluntary 'Third Pillar' can be loosely defined and broad in nature. It generally consists of personal savings and non-mandatory contributions to retirement plans. Such voluntary savings used for consumption through retirement are derived from sources that are not formally defined as pensions.[48]

Voluntary contributions can be concessional (tax deductible) or non-concessional (post-tax). Voluntary contributions are limited, with each limit determined by the member's age and type of contribution. Levels of income or wealth of an individual are irrelevant in determining contributions limits.[54] Lower income earners are encouraged to voluntarily contribute to superannuation, with post-tax savings, in order to receive a co-contribution from the government. Lower income earners can receive a co-contribution of 50 percent up to A$500 on their contribution.[55] Despite not being mandated, voluntary superannuation contributions are also preserved until a condition of release is met (e.g. p

Hong Kong also delivers social services and benefits to their elderly, including

management increase over time, so too will competition; consequently reducing costs. However, there remains the real risk that costs will increase if no action is taken.[85]

Australia has had the advantage over Hong Kong in that its SG system has been in place for almost a decade longer. Over this time it has developed efficiencies and competition which have been the drivers of a reduction in fees. Due to the passive approach that many Australians still have to superannuation, the government developed the concept of a default 'MySuper' product. This product is required to feature a standardised, transparent fee structure and reporting, as well as basic lifecycle investment options, ensuring the savings of passive-decision makers are invested appropriately and cost-effectively. MySuper products became available as of July 2013 and, by 2017, all superannuation trustees are required to transfer 'default balances' into a MySuper product.[86] MySuper product fees now rival international retirement plans.[87]

3.4 Sustainability: Australia and Hong Kong

> A sustainable system is one that is financially sound and can be maintained over a foreseeable horizon under a broad set of reasonable assumptions
>
> — World Bank Pension Conceptual Framework[88]

Assistance to older Australians is Australia's largest single welfare cost, accounting for 39 percent of total social security and 13 percent of total budget spending. The cost of this support to the aged, while not expected to decrease in the near future, is expected to plateau.[89] Maintaining this proportion of spending towards the elderly should be viewed as an improvement towards sustainability when considering that those aged 65 and over accounted for 14 percent of Australia's population in 2011 and will increase to 20 percent of the population by 2030.[90] The anticipated curbing of budget spending towards this sector can be largely attributed to the proposed changes (reversion) of means testing, set to apply from 1 January 2017.

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