The current retirement system in Australia needs to be more attuned to a mobile international workforce: a case for reform

Rhys Cormick
University of Canberra

John A. McLaren
University of Wollongong, johmcl@uow.edu.au

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Keywords
attuned, mobile, international, workforce, case, reform, system, australia, needs, be, current, more, retirement

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Rhys Cormick* and John McLaren#

Abstract

Dealing with the fiscal impacts of Australia’s ageing population is potentially the most important issue for the next 30 years. The majority of countries in the developed world are facing an ageing population due to sustained low fertility and increased life expectancy. In order to reduce the fiscal burden following this decreased labour force participation and increased age-related spending, governments must appropriately design retirement savings systems to protect their budget, the taxpayers and the elderly. Individuals are increasingly taking up employment in foreign countries. Such international labour mobility provides a number of economic benefits for both the home and host country and may assist in stimulating the economy in light of an ageing population. Despite the internationalisation of labour, there is no consensus or uniformity regarding a model of retirement taxation. Australia’s model of retirement taxation is unique in the world, sitting as an outlier in comparison with other Organisation of Economic Co-Operation and Development (OECD) nations. As a result of mobile retirees and workers, and with a variety of incongruous models of retirement taxation, the retirement taxation systems of the world present major problems in allocating the right to tax. Expatriate employees will often find themselves subject to double taxation on portions of their retirement funds or subject to harsh penalties for the transfer of their retirement benefits and the home or host state will often lose its right to tax. The aim of this paper is to identify a number of problems that a globally mobile workforce presents to the current state of retirement fund taxation, especially from an Australian perspective. The paper will also provide a number of recommendations for reform in this area of law.

I INTRODUCTION

The aim of this paper is to highlight the taxation problems that arise when an Australian worker chooses to obtain employment in another country and contribute to their retirement savings in that country. They may also have retirement savings in Australia that have been accumulated before they leave. They may eventually return to Australia to retire. Similarly, a foreign worker may obtain employment in Australia and contribute to

* Law and Commerce graduate, University of Canberra. This paper is based on the Honours Thesis.
# Senior Lecturer, Faculty of Business, University of Wollongong.
retirement savings while working here but may wish to return to their home country to retire. This may be the case with skilled foreign workers in Australia employed under a 457 visa. The taxation of retirement savings differs from country to country and on retirement may present the taxpayer with taxation penalties and problems that act as a disincentive to move or retire to a particular country. This issue must be seen within the context of an ageing population in Australia and elsewhere where the need to maximise retirement savings is of paramount importance.

Every country in the developed world, bar 18 demographic outliers, is facing an ageing population. According to Australian Bureau of Statistics (ABS) figures, in 2007, just 13 percent of Australia’s population was aged 65 years and over, with only 1.6 percent of those aged over 80. ABS projections indicate that by 2056, 24 percent of Australia’s population will be over 65 with 7.3 percent over 85. By 2046, it is estimated that over one quarter of Australia’s population will be aged 65 years and over. This ageing population is largely a product of sustained low fertility and increased life expectancy, combined with the approaching retirement age of the world’s ‘baby boomers’ born between 1946 and 1964. A consequence of this ageing population is that the ratio of people working to support those in retirement will significantly decrease: for each older person in 2007, there were five working-age people; while in 2056 there will be less than three working-age people for every older person. The OECD’s Pensions at a Glance 2013 highlights that this declining ratio of workers to retirees is consistent amongst the OECD member countries, with the OECD average ratio tipped to decrease to just 1.9:1 by 2060. This ageing population encountered across the world has a number of significant economic and fiscal consequences.

As older workers retire, their incomes will be reduced while also facing large and important expenses such as health care and retirement accommodation. Those aged over 65 in Australia have some of the lowest incomes in relation to the working population in comparison with the majority of OECD countries. Australian retirees also have substantially higher income-poverty rates than the Australian population and the OECD average. If retirees are not self-sufficient, they will have to rely on government assistance

3 Ibid.
4 Ibid.
6 Ibid.
8 Ibid 162.
9 Ibid 165.
to meet expenses. The funding for such expenses will have to be met by the existing labour force or through increases in taxes or government borrowing. The 2010 Intergenerational Report by the Australian Treasury identifies that the ageing population will have substantial economic and fiscal consequences in Australia.\textsuperscript{10} According to the Treasury, the ageing population is the major factor driving the forecasted slowing economic growth due to the decreasing labour force participation and government expenditure required to maintain those in retirement.\textsuperscript{11} While Australian government expenditure on health, age-related pensions and aged-care is currently already more than a quarter of total spending, by 2049-2050 it is estimated to increase to almost half of total government spending.\textsuperscript{12} In order to curtail the impact of slowing economic growth and excessive public spending on age-related services, Australia’s taxation system must provide appropriate incentives for increased productivity and reduced fiscal strain.

\textbf{A The need for a supportive retirement system}

The development of a strong retirement system to support an ageing population is vital to minimise government expenditure, lower the tax burden and reduce the impact of excessive demand on the health and welfare system. As described by the World Bank’s 1994 report titled, ‘Averting the Old Age Crisis’, the onset of an ageing population across the world is putting increasing strain on the retirement systems and overall economy of these nations:

Systems providing financial security for the old are under increasing strain throughout the world. Rapid demographic transitions caused by rising life expectancy and declining fertility mean that the proportion of old people in the general population is growing rapidly. Extended families and other traditional ways of supporting the old are weakening. Meanwhile, formal systems, such as government-backed pensions, have proved both unsustainable and very difficult to reform. In some developing countries, these systems are nearing collapse. In others, governments preparing to establish formal systems risk repeating expensive mistakes. The result is a looming old age crisis that threatens not only the old but also their children and grandchildren, who must shoulder, directly or indirectly, much of the increasingly heavy burden of providing for the aged.\textsuperscript{13}

It is therefore vital that the retirement support system is strong and efficient in order to place the government, retirees and the workforce in the best position to support an ageing population. The World Bank lists the three pillars of retirement support in establishing a strong foundation for a nation’s retirement as the following:

(i) state provision of support through a pension scheme;
(ii) compulsory occupational schemes whereby the employer makes provision for money to be paid into a retirement fund; and

\textsuperscript{10} Wayne Swan MP, ‘Australia to 2050: future challenges’ (Commonwealth of Australia Attorney General’s Department, 2010) ix.
\textsuperscript{11} Ibid.
\textsuperscript{12} Ibid xv.
Australia’s retirement system adopts this three-pillar approach to retirement savings through both mandatory and optional saving through a retirement fund referred to in Australia as a ‘superannuation fund’, combined with a means-tested government pension. Currently in Australia, employers are required to contribute 9.25 percent of the salary or wage paid to an employee and the employee can contribute an extra amount up to a specified limit. Superannuation is the second primary source of private wealth in Australia with private investment in owner-occupied housing as the main source of retirement savings. Almost all personal saving in Australia is directed into superannuation or owner-occupied housing. The first pillar of Australia’s retirement savings system is the means-tested aged pension which ensures all Australian’s have access to a safety net level of income throughout their retirement that is considered by the government to be sufficient in order to provide a reasonable minimum standard of living.

Being taxpayer funded, the means-tested aged pension is a government expense that will increase along with Australia’s ageing population. It is therefore vital that the remaining two pillars are effectively designed to ensure a limited fiscal burden of the aged pension. Because the remaining two pillars, namely an employer sponsored retirement payment and private savings place the burden on the private sector and not the public, a greater reliance on these two pillars ensures reduced government expenditure. While the aged pension is an important aspect of Australia’s retirement system, the focus of this paper is on the remaining two pillars embodied through Australia’s superannuation system.

The second pillar of Australia’s retirement savings system is mandatory savings embodied in the ‘superannuation guarantee charge’ (SGC). The SGC supports Australia’s ageing population problems by requiring the labour force to save for their own retirement expenditure. The third pillar of Australia’s retirement savings system is voluntary savings. Voluntary retirement savings are embodied through voluntary superannuation contributions encouraged by generous tax concessions but can also be viewed more broadly to include other forms of lifetime voluntary savings such as home ownership. The 2009 ‘Australia’s future tax system’ review recognised that while Australia’s three-pillar approach to retirement savings is unusual among developed countries, it has

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14 Ibid 15.
15 Superannuation Guarantee (Administration) Act 1992 (Cth) and the Superannuation Guarantee Charge Act 1992 (Cth). The maximum amounts that can be contributed by an employer before additional taxes may be payable are, from 1 July 2014, $30,000 and $35,000 if aged over 49.
17 Ibid.
18 Australia’s Future Tax System Review Panel (K Henry (Chair), J Harmer, J Piggot, H Ridout and G Smith), Australia’s future tax system: The retirement income system (December 2009), 10.
19 See generally Dr Jeff Harmer, Department of Families, Housing, Community Services and Indigenous Affairs, Pension Review Report (27 February 2009).
21 Above n 19, 13.
considerable strengths in satisfying retirement needs and spreading the risk between the public and private sector in a fiscally responsible manner. The review recommended that the current three-pillar retirement system be preserved and there is no indication that the current Australian government intends to alter the current structure.

B A globally mobile labour force

Just as populations are ageing, the labour force is becoming increasingly mobile on an international scale. Many Australian taxpayers are attracted to the prospect of temporary or permanent employment in a country other than the individual’s home country. Such a practice is also commonly referred to as skilled migration. Migrants are transferred all around the world for temporary and long-term employment contracts. Mining, engineering, information technology and accounting are among the most globally mobile professions. Labour migration provides a number of economic benefits for both the home and host country. The host country benefits from increased output and in the long run both countries’ wages will move towards equilibrium, resulting in the lower waged country workers being better off and the higher waged country owners being better off due to increased productivity. Skilled migration facilitates a sharing of highly educated and skilled workers and increases international competition for human capital. Labour migration will also impact the composition of trade and output in the countries involved. However, outward labour migration can have negative economic impacts on countries, particularly developing countries, due to the drain of their educated and skilled labour. While the correct policy stance on this issue is unclear, the benefits and occurrence of such international labour migration is prevalent. However, taxation issues become extremely important for those workers who wish to retire in their country of birth but have their retirement savings in the country where they worked. Similarly, migrant workers wishing to retire in their new country may have retirement savings in their country of birth which they accumulated when they first started working. The main question raised in this paper is ‘what are the taxation consequences for taxpayers who accumulate superannuation benefit in multiple countries over their working life?’

22 Ibid 8.
23 Ibid.
25 Contra Bob Birrell and Ernest Healy ‘The Impact of Recent Immigration on the Australian Workforce’ (Centre for Population and Urban Research, February 2013).
27 Ibid 294.
28 Ibid 299-300.
For mobile retirees and workers existing in a world with incongruous models of retirement taxation, the retirement taxation systems in other countries present major problems in allocating the right to tax retirement savings. Expatriate employees will often find themselves subject to double taxation on portions of their retirement funds or subject to harsh penalties for the transfer of their retirement benefits and the home state or the state where the taxpayers wishes to retire will often lose its right to tax. The aim of this paper is to identify a number of problems that global mobile workers face when confronted with the current state of retirement fund taxation in Australia, and some other countries. In providing examples of the integration and non-integration between Australia, Hong Kong, New Zealand and the United Kingdom’s retirement funds, the following concerns with retirement fund taxation are identified:

1. Non-recognition of contributions to foreign retirement funds;
2. Double taxation and double coverage of contributions to retirement funds;
3. Double taxation by attribution of foreign retirement fund investment income to the individual;
4. Double taxation of lump sums;
5. Lack of certainty in double taxation agreements;
6. Concessional tax treatment for retirement savings which operate under the false premise that the individual will retire in that state;
7. Lack of consensus in the model of retirement taxation;
8. Double taxation on international transfers.

This paper will provide a number of possible solutions to these problems and they are summarised as follows:

1. Expand the application of pension exemptions under Australia’s double tax agreements to include lump sum payments in order to provide greater certainty to expatriates;
2. The adoption of a uniform model of retirement taxation;
3. Elimination of international transfers;
4. Adoption of international pension plans;
5. Adoption of multilateral treaties on retirement fund taxation;
6. Creation of an international body governing retirement funds and international labour.

However, a number of these recommendations are greatly hindered by the stark differences in retirement fund taxation policies between countries. It is clear from the problems presented that there is no easy solution to the reform of retirement taxation for globally mobile employees. International mobility therefore presents a difficult dilemma for the allocation of taxing rights and the avoidance of double taxation. Moreover, the discussion undertaken here only focuses on a small aspect of retirement savings. While the reform of retirement funds to cater for such expatriates is not currently on the political agenda, the
ageing population problems facing the world combined with global labour mobility may soon see the issue gaining greater significance.

The second chapter in this paper will identify the structure of retirement systems and the models for taxing retirement funds. This chapter will also discuss the occurrence and importance of global mobility. Chapter three will discuss examples from the integration between Australia, Hong Kong, New Zealand and the United Kingdom’s retirement funds to identify the concerns mobile labour presents to the current system of retirement fund taxation. This chapter will draw on the OECD’s principles to determine which states should have the right to tax the various transactions within retirement funds. Chapter four provides a number of possible solutions for reforming retirement systems to be more compatible with global labour mobility.

II MODELS OF RETIREMENT TAXATION

The lifecycle of a retirement fund can be segregated into three transaction phases: contributions, earnings and benefits. Money that is paid into a retirement fund is made by the employer on behalf of the employee and the employee may also be permitted to make further contributions from their salary or wage. Different countries have different percentages at which contributions may be made. This is one of the three pillars of retirement savings in terms of the World Bank recommendations. The money in the retirement fund is then invested on behalf of the member or employee and these funds are usually managed by governments. Government pension funds are recognised as a form of sovereign wealth funds and may attract special tax benefits on their earnings when invested in other counties. On retirement, the member or former employee is entitled to benefits from the fund and they are able to obtain a share of the fund in the form of a pension or lump sum or a combination of both which will be free of further income tax or subject to income tax at varying rates.

The different taxation systems that are applied to retirement funds in different countries are set out below. The levels of taxation applied at these three distinct stages constitute different taxation arrangements:

- Capital ‘T’ represents fully taxed, referring to the same marginal tax rate as that on income;
- Lower case ‘t’ represents a lower tax rate, or as is the case in Australia, ‘concessionally’ taxed; and
- Capital ‘E’ means that the benefits are exempt from further income tax on retirement.29

Retirement savings systems known as ‘comprehensive income tax regimes’ tax contributions made to a fund and tax the earnings generated through investments within a

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29 Above n 15, 4.
fund, but generally exempt from income tax the benefits paid to the retiring employee.\textsuperscript{30} Such systems are referred to as ‘taxed-taxed-exempt’ (TTE) schemes.\textsuperscript{31} By way of contrast to the TTE system is the pure expenditure tax regime where contributions and earnings are exempt but the final benefits that are paid to the retired employee are taxable. Such systems are referred to as ‘exempt-exempt-taxed’ (EET) schemes.\textsuperscript{32} The key economic difference between TTE and EET schemes is that EET schemes allows a greater amount of retirement benefits to be compounded over a member’s lifetime by not reducing the funds accrued savings by the imposition of income tax on both the contributions and earnings within the fund. The majority of OECD countries have an EET regime.\textsuperscript{33} The Australian system comes under a great deal of criticism on this aspect of its design income tax, even at the concessional rate of 15 percent, reduces the amount invested and accumulating over the working life of the employee.

The retirement systems in Hong Kong and the United Kingdom are EET schemes. New Zealand has a TTE regime and Australia has a tTE regime for private sector employees and an ‘exempt-exempt-taxed’ (EET) regime for government sector employees. As demonstrated in Table 1 below, both the Australia and New Zealand regimes of retirement taxation are outliers in comparison with the majority of OECD countries. The majority of OECD nations have adopted an EET model of retirement taxation. As will be demonstrated in the next chapter, this non-uniformity in retirement taxation models makes it problematic to allocate the right to tax and avoid double taxation for the retirement benefits that are paid to expatriate employees.

\textsuperscript{30} Kwang-Yeol Yoo and Alain de Serres, \textit{Tax Treatment of Private Pension Savings in OECD Countries} (OECD Economic Studies No. 39, 2004/2) 75.
\textsuperscript{31} Ibid.
\textsuperscript{32} Ibid 76.
\textsuperscript{33} Ibid.
Table 1: Tax Treatment of Private Pensions in Selected OECD Countries.34

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III TAXATION ISSUES WITH RETIREMENT FUNDS

This chapter will identify a number of situations where the systems of retirement fund taxation adopted by Australia, Hong Kong, New Zealand and the United Kingdom fail to adequately recognise global mobility. This chapter is broken up into four stages: contributions, investment income, benefits, and international transfers. These four stages represent the three transactions of retirement funds with the addition of international transfers which occurs when an individual seeks to transfer their retirement fund balance from one country to another.

One of the major problems occurring throughout the various stages of retirement savings taxation is the occurrence of double taxation and uncertainty regarding which state has the right to tax. The occurrence of double taxation and double non-taxation in the treatment of migrants’ retirement benefits creates the major dilemmas associated with the erosion of equity for such migrant’s retirement funds and the erosion of the state’s tax base. When two separate states impose tax on a given transaction, there will be a significant disincentive for economic activity of that nature to occur. This erodes the equity of migration for the migrant and thus creates a significant disincentive to labour migration. The two approaches to allocating taxing rights to a state are taxing the country of residence

34 Adopted from Above n 15, 4.
or the country where the income is sourced.\textsuperscript{35} Double taxation predominately occurs in transactions with an international element when states disagree on whether the country of source or the country of residence has the right to tax.

Chapter V of the OECD Model Convention with Respect to Taxes on Income and Capital (the OECD Convention) lists the two primary methods for the elimination of double taxation as the exemption method and the credit method; either providing an exemption for foreign income or deeming it taxable but providing a tax credit for foreign income tax paid.\textsuperscript{36} To make an interpretation as to which state has the right to tax the different retirement transactions, the OECD Convention will be extended to each stage of retirement system transactions as well as intentional transfers. It should be noted that the OECD Convention is not international law but rather non-binding soft law that may influence the policy of contracting states.\textsuperscript{37}

\textbf{A Contributions to a retirement fund}

The contributions stage is where retirement savings are contributed to the retirement savings account. The most common ways this occurs are mandatory contributions as a proportion of an employee’s salary and voluntary contributions either from an employee’s salary or from private savings. As discussed in chapter two, most countries provide an exemption or reduced taxation on contributions to a retirement savings account. Employers are generally also allowed a deduction for contributing to an employee’s retirement savings account similar to a deduction for the payment of salary and wages.

The OECD Convention does not specifically hold a view regarding retirement fund contributions; however, it does hold a view regarding income earned from employment. Under Article 15, employment income is taxed in the state in which the employment is exercised, unless the individual is in the state for less than half the year and paid by a company located outside that state.\textsuperscript{38} After-tax contributions, being already taxed by a state, are generally tax exempt. Pre-tax contributions, being contributions deducted from an individual’s employment income before being subject to income tax, should therefore be taxed by the state which has the right to tax the employment income. The problems associated with the combination of retirement taxation and global mobility are the potential for double taxation of retirement fund contributions and the non-recognition of contributions to foreign retirement funds.


\textsuperscript{36} Organisation for Economic Co-Operation and Development, \textit{Articles of the Model Convention with Respect to Taxes on Income and Capital}, (as they read 17 July 2008) ch V.

\textsuperscript{37} John McLaren, “The OECD harmful tax competition project: is this international law?” (2009) 24(3) \textit{Australian Tax Forum} 423.

\textsuperscript{38} Organisation for Economic Co-Operation and Development, \textit{Articles of the Model Convention with Respect to Taxes on Income and Capital}, (as they read 17 July 2008) art 15.
The primary problem with allocating the right to tax contributions arises when an individual works in one jurisdiction and seeks to contribute employment income to a retirement fund located in another jurisdiction. In this instance, the country of source is the state in which the individual is working and the country of residence is the state in which the retirement fund is a resident. Australia does not allow the employer or employee to claim deductions against income tax for funds contributed to a foreign retirement fund. This policy ensures that the country of source gains the right to tax contributions; however, this approach makes enrolment in that jurisdictions’ retirement scheme mandatory in order for an employer to make deductions from their employment income. New Zealand and Hong Kong allow employers to claim deductions for contributions made on behalf of an employee to a foreign retirement fund, however the employee is still subject to income tax in New Zealand and Hong Kong respectively on this contribution. If the foreign retirement fund taxes contributions, the employee will thus be subject to double taxation.

A(i) Non-recognition of contributions to foreign retirement funds

The United Kingdom is the only country which allows both the employee and employer to claim a deduction against income tax on funds contributed to a recognised foreign retirement fund. Under migrant member relief, employers are allowed tax deductions and individuals are granted UK tax relief on contributions paid to foreign retirement funds from UK employment income. Migrant member relief thus shifts the taxing right to the resident country. In Australia for example, this contribution will be taxed as a normal concessional contribution at 15%, whereas the United Kingdom foregoes its right to tax. This practice is unique in that the United Kingdom is forgoing its right to tax income earned from salaries and wages in recognition of the retirement funds of other nations. While such practice is not required under the OECD principles, it does offer a strong incentive for expatriates to work in the United Kingdom as they may retain their home countries retirement plan. The inability of foreign employees working in Australia or Hong Kong to receive tax deductions for contributions made to foreign retirement funds ensures that the country of source gains the right to tax contributions. Such policy however, makes enrolment in that jurisdictions’ retirement scheme mandatory in order to make deductions and requires expatriates to establish multiple retirement accounts.

A(ii) Double coverage of contributions to retirement funds


40 *Inland Revenue Ordinance* (Hong Kong) Cap 112, reg 117(1)(1)(ii); *Income Tax Act 2007* (NZ) ss DC 7, YA 1; *KiwiSaver Act 2006* (NZ) s 64.

41 *Finance Act 2004* (UK) 5 Eliz 1, c 12, sch 33; *The Pension Schemes (Relevant Migrant Members) Regulations 2006* (UK).

A further concern associated with the allocation of taxing rights to contributions arises when one country requires mandatory contributions to be made on the basis of source and the other country requires contributions to be made on the basis of residence. For example, employees required to work in Australia by their employer in their home country may therefore be subject to ‘double superannuation coverage’ by their employer being required to pay superannuation contributions both in Australia and their home country for the same work.\(^{43}\) Australia has enacted a number of bilateral agreements on superannuation contributions which generally exempt the home country employer from making superannuation contributions in Australia, provided contributions are made in the home country.\(^{44}\) Of the four countries examined in this paper, Australia only has such an agreement with New Zealand.\(^{45}\) Australia intends to address double superannuation coverage in all future international social security agreements.\(^{46}\) This issue has thus been recognised and is being addressed by Australia.

**B Investment income**

Investment income is the earnings made on the funds that are invested in a retirement savings account. The savings held in retirement funds often make up a significant proportion of a country’s mobile capital. Different funds have different risk and asset allocation strategies to suit the needs of their members. Income on investment funds takes the normal form of investment income such as interest, dividends, royalties, rent and capital gains and may be invested either within that country or in other countries. Typical investments include securities, bonds, annuities as well as long term infrastructure projects and property.

Under the OECD Convention, passive income from dividends and interest are taxed by the state in which the recipient entity is a resident.\(^{47}\) The state in which the income is sourced is generally entitled to a withholding tax of up to 15% however this amount is generally determined by any double taxation agreement between the two states.\(^{48}\) Capital gains are generally taxed on the basis of residency, however if the gain is made on immovable property situated in the external state, that state will have the right to tax.\(^{49}\) Because of the concessional tax treatment accorded to retirement funds within their own jurisdiction, most jurisdictions exempt the taxation of passive income earned by foreign retirement funds within their jurisdiction. The problem with retirement fund taxation and global mobility is

\[^{43}\text{International Tax Planning- Expatriates and Migrants (CCH IntelliConnect, 2013) 2-100.}\]
\[^{44}\text{Ibid.}\]
\[^{45}\text{Ibid.}\]
\[^{47}\text{Organisation for Economic Co-Operation and Development, Articles of the Model Convention with Respect to Taxes on Income and Capital, (as they read 17 July 2008) art 10, 11.}\]
\[^{48}\text{Ibid.}\]
\[^{49}\text{Above n 35, 13.}\]
the double taxation of investment income due to the attribution of foreign retirement fund investment income to the individual.

\[ B(i) \text{ Double taxation by attribution of income to the individual} \]

The concern with the allocation of taxation rights to investment income occurs when one state attributes investment income earned by a foreign retirement fund to the individual. This is a situation of both states claiming the right to tax based on the concept of residency in relation to the same income. While the recognition of legitimate tax avoidance vehicles is imperative to reducing harmful tax practices, it must be ensured that the retirement policies of other states is not hindered by the taxation of foreign retirement funds. The taxation of passive income within the retirement fund, being taxed at source, depends on which state the fund is recognised as a tax resident. The United Kingdom, Australia and Hong Kong generally recognise foreign retirement funds as separate tax residents from their member.\(^{50}\) This approach is consistent with the OECD Convention and appropriately allocates the taxing right based on the country of residency even if that country adopts a policy of exempting investment income. New Zealand however, does not comply with this norm, but rather attributes income earned in foreign retirement funds owned by New Zealand residents to the individual.\(^ {51}\)

While New Zealand’s treatment is consistent with the taxation of its own ‘KiwiSaver Accounts’, it fails to recognise the separate legal identity of the trust and the member for tax purposes and may subject the member to double taxation. In the United Kingdom and Hong Kong, earnings within the fund are generally untaxed.\(^ {52}\) Income earned within an Australian fund is taxed to the member and taxed according to their proportion of tax-free and taxable benefits.\(^ {53}\) New Zealand is unique in this respect as it bases the rate of taxes on investments within funds on the individual’s marginal rate of tax outside of the retirement fund and may include in this amount income from foreign retirement funds.\(^ {54}\) Consequently, individuals in New Zealand with interests in retirement funds outside New Zealand are subject to double taxation. Interests in Australian superannuation funds are an exception to this due to the special recognition accorded between Australia and New Zealand.

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\(^{50}\) Such income is exempt in UK and HK: Finance Act 2004 (UK) 5 Eliz 1, c 12, ss 186-187; Inland Revenue Department, Recognised Retirement Schemes, DIPN 23 (Hong Kong, September 2006); Ayesha MacPherson Lau and Garry Laird, Hong Kong Taxation Law & Practice (Chinese University Press, 2012-2013 ed., 2012) 693-394.

\(^{51}\) Income Tax Act 2007 (NZ) ss EX 28, CQ 5.

\(^{52}\) Finance Act 2004 (UK) 5 Eliz 1, c 12, ss 186-187; Inland Revenue Department, Recognised Retirement Schemes, DIPN 23 (Hong Kong, September 2006); Ayesha MacPherson Lau and Garry Laird, Hong Kong Taxation Law & Practice (Chinese University Press, 2012-2013 ed., 2012) 693-394.


\(^{54}\) See Inland Revenue Prescribed Investor Rate (PIR) (30 August 2011) Inland Revenue Department <http://www.ird.govt.nz/toii/pir/>
Australia, to some extent, may also attribute the income in foreign retirement funds to the individual. Foreign retirement funds, if caught under the controlled foreign company rules, transferor trust regime or general anti-avoidance provisions may have severe tax consequences for the individual. A ‘Taxpayer Alert’, issued by the ATO in Australia, namely TA 2009/19 ‘uncommercial offshore superannuation trusts’ applies to such arrangements that undertake uncommercial shifting of funds into foreign superannuation funds or intended to be used to bring funds back into Australia’s concessationally taxed environment. The application of such provisions will generally only come into effect if the fund is not established for the provision of retirement benefits but rather as a means of accessing benefits early, such as by making investments in entities that are related to the members.

C Pensions

When a member of a retirement fund begins withdrawing their retirement savings, this is referred to as the ‘pension phase.’ Members are permitted to withdraw their savings when they meet certain conditions such as meeting a minimum age requirement, permanently retiring from work or becoming permanently disabled. The requirements for withdrawal vary based on the rules and policies of a given country. Retirement funds can generally be withdrawn through a number of means, most commonly through a lump sum payment, where all or substantially all of the savings are withdrawn at once, or though a pension payment, where the member receives an income stream from the fund. Some other retirement funds not discussed in this paper may operate as an insurance or annuity where a specified payment is calculated and paid in the event of the member’s retirement.

Double tax agreements do not appropriately designate which state should tax the investment earnings component of a pension payment. The OECD convention indicates that the component of a pension in respect of employment should only be taxed in the state in which it was earned but does not provide guidance for the treatment of the investment earnings of these funds. Under Article 18 of the OECD convention, pension income from employment is taxed at source:

...pensions and other similar remuneration paid to a resident of a Contracting state in consideration of past employment shall be taxable only in that state.

Article 18 only states that such pension income in respect of employment should be taxable in that state. There is no indication as to who has the right to tax pension income on funds that were earned by passive investment, namely the earnings on the fund during

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55 Australian Taxation Office, *Uncommercial offshore superannuation trusts*, Taxpayer Alert 2009/19 (15 December 2009). Taxpayer alerts are issued by the Australian Taxation Office to alert taxpayers and advisers that their arrangements are viewed as being at a high risk of assessment and review by the administrators from a tax avoidance perspective.

56 Ibid.


58 Ibid.
the working life of the employee. When applying the principles of taxing passive income such as investment income within a retirement fund, this will be taxed by the state to which the fund is a resident, and the state from where the income is sourced may then have the right to withhold tax on that same income. Article 18 should therefore clarify that pensions in respect of past employment and the earnings on such funds should only be taxable in the state in which the employment income was earned. Pension income should therefore not be differentiated between employment income and passive or investment income, but should remain taxable solely by the state where the retirement fund is a resident for tax purposes.

The taxation of pension income in the state where the fund is a resident is consistent with the double taxation agreements between all states. Hong Kong’s double tax agreements with New Zealand and the United Kingdom specifically render lump sum pension payments as subject to income tax only within the state in which the fund is a resident.

C(i) Double taxation of lump sums

Australia allows a period of six months from resuming Australian tax residence for an individual to take a lump sum untaxed in Australia before it is subject to tax at the individual’s marginal rate. If the individual is a New Zealand resident, New Zealand may tax lump sums as a dividend received from a foreign investment fund. The treatment of foreign lump sums within these two states therefore does not accord the same concessional recognition as the treatment of pensions. While there may be justification in such an approach by preventing a resident taxpayer of a state having access to ceaseless tax-free benefits held in a foreign state’s retirement fund, there must be greater recognition of such payments in order to avoid double taxation.


60 Income Tax Assessment Act 1997 (Cth) ss 305-60, 305-70; 305-75; Australian Taxation Office, Superannuation: Lump sums received from foreign superannuation funds by Australian residents: relevant periods under subsection 305-75 of the ITAA 1997, ATO ID 2009/124 (12 October 2009); Tubemakers of Aust Ltd v FCT (1993) 25 ALR 183.
D International transfers

An international transfer is the transfer of a member’s retirement savings held in one country to those in another. When a member works over different countries over their working life they may accrue retirement benefits in different countries. Members are generally not required to transfer the benefits from one country to another, the requirements to undertake such a transfer vary based on the laws and policies of each country.

The concessional tax treatment for retirement savings funds works on the false assumption that the individual will retire in that state. The goal of retirement savings taxation to provide for an individual’s retirement within that state is misdirected because workers do not always retire in the same country that their retirement benefits have been accrued. As investigated in the first part of this paper, Australia’s rationale for establishing retirement savings funds and providing concessional tax treatment on such funds is to reduce the fiscal burden of retirement on the Australian budget. Concessional tax treatment is thus provided to individuals in order to increase their retirement savings which will consequentially decrease those individual’s reliance on state assistance. Under such justification, a state should not have to provide concessional tax treatment to individuals who will not retire within that state as their retirement expenses will not be supported by that state. One state should not have to provide tax concessions on employment income earned within that state in order to reduce the economic burden of that individual’s retirement in another country. Because both employees and retirees are globally mobile, the state which taxes their retirement funds and provides concessional tax treatment to them is not necessarily the country in which they will retire.

This predicament is not limited to international transfers but is inherent in the entire structure of retirement fund taxation. The biggest difficulty in allocating the right to tax arises when a retiree or member of the fund transfers their retirement balances between different countries. Because the rationale for the creation of retirement savings accounts is to force the employee to save in order to alleviate the pressures on society in their retirement, it is justifiable that such a country can tax outbound transfers in order to recoup the income tax lost as a result of providing tax concessions on the contributions and earnings of the fund. Because the fund is a resident of the outbound state and all contributions and investment income are accrued within that state, the outbound state has the right to impose income tax. Equally, a state that taxes contributions and investments of a retirement fund that then receives a transfer from a foreign retirement fund foregoes a portion of tax that would have accrued over the first two transactions. With retired workers not necessarily retiring in the jurisdictions in which they accrue their retirement benefits, problems of tax allocation and international transfers therefore arises.

D(i) Lack of consensus in the model of retirement taxation
The lack of consensus regarding the correct model of retirement taxation makes the allocation of taxing rights in international retirement fund transfers problematic. If all states operated on a TTE or TTT model, the allocation of taxing rights would be relatively simple: the outbound state has already levied their tax and the receiving state would not forgo revenue in a TTE model and still receive revenue under a TTT model. If all states operated on an EET model, international transfers would occur by the first state levying a withholding tax to recoup the tax foregone. In order to provide equity and avoid double taxation the second state could provide a foreign tax credit for tax already paid in the other state that would be creditable against the retirement benefits income.

With the transfer from an EET model to a TTE model however, members may seek to transfer their balances from an EET to a TTE during the pension phase, resulting in double non-taxation. However, if both the inbound and outbound states chose to levy a tax to recoup the income tax lost as a result of the tax concessions foregone, double-taxation will occur. Determining which state has the right to impose income tax in such a situation is therefore unclear. Equally, with the transfer from a TTE to an EET, double-taxation will occur unless one state foregoes its right to tax. The lack of uniformity in retirement taxation models therefore means either double taxation or double non-taxation will occur when there is a disparity between the retirement taxation models of the transferring countries.

D(ii) Double taxation on international transfers

Taxes can be imposed on international transfers by both the state in which the funds are received and the country from which the funds depart. In Australia, a transfer from a foreign superannuation fund, except a New Zealand ‘KiwiSaver’ Account, to a complying superannuation fund\(^{61}\) is assessable income for the Australian fund, taxed at 15 percent.\(^{62}\) An eligible temporary resident of Australia may be eligible to receive their superannuation contributions and earnings within the fund early as a departing Australia superannuation payment.\(^{63}\) The departing Australia superannuation payment is not taxed under the superannuation lump sum payment rules and is non-assessable, non-exempt income in Australia for the receiving individual.\(^{64}\) Instead, relatively high rates of withholding tax are imposed on the departing Australia superannuation payment at 45 percent on untaxed elements, 35 percent on taxed elements and nil tax on tax-free components.\(^{65}\) The 2014

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61 The term ‘complying superannuation fund’ means that the fund complies strictly with the objectives of the Superannuation Industry (Supervision) Act 1993 (Cth). A complying fund is eligible to pay income tax at the concessional rate of 15 percent. A non-complying fund pays income tax on the contributions and earnings at 45 percent.
62 Income Tax Assessment Act 1997 (Cth) ss 295-190(1); 295-200; 305-80.
63 Ibid ss 301-170; 301-175.
65 Superannuation (Departing Australia Superannuation Payments Tax) Act 2007 (Cth) s 5; Income Tax Assessment Act 1997 (Cth) s 301-175(2).
Federal Budget has proposed to temporarily increase these amounts for three years to 38 percent and 47 percent respectively. Tax free components would constitute amounts that the employee has contributed from their after tax income.

Special rules govern the treatment of transfers between Australian complying superannuation funds and New Zealand KiwiSaver schemes under the ‘Arrangements between the government of Australia and the Government of New Zealand on Trans-Tasman Retirement Savings Portability’ (Trans-Tasman Arrangement). Under the Trans-Tasman Arrangement, Australia and New Zealand will exempt retirement savings transfers between each other country from any entry or exit taxes. This includes New Zealand treating such payments as dividends or seeking to recover member tax credits and Australia withholding tax on withdrawals. The departing Australia superannuation payments regime does not apply to Australian and New Zealand resident citizens and permanent residents; therefore, an amount transferred from an Australian superannuation fund to a New Zealand KiwiSaver Account is not taxed under the departing superannuation payments regime as discussed above.

The amounts transferred into an Australian complying superannuation fund from a KiwiSaver Account are personal, non-concessional contributions that are not included in the assessable income of the Australian superannuation fund. Australian sourced savings in superannuation that have been transferred to a KiwiSaver Account and then back into the superannuation fund do not count towards the non-concessional contributions cap in Australia when transferred back into Australia. If the contribution exceeds the non-concessional contributions cap, the transfer will be subject to the excess contributions tax. The maximum value of retirement savings is therefore AUD 450,000 when utilising the bring-forward provisions. This provision is severely limiting for individuals with savings in excess of AUD 450,000.

IV RECOMMENDATIONS FOR REFORM

The following six recommendations provide possible solutions to the problems raised by taxpayers working in more than one country and retiring in a new country or returning to their home state. The current approach to the way in which retirement incomes are subject to income tax must be reconsidered by all nations, but especially those countries that supply mobile labour to other nations or are attractive destinations for skilled workers.

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66 Superannuation (Departing Australia Superannuation Payments Tax) Amendment (Temporary Budget Repair Levy) Bill 2014 (Cth).
67 Arrangements between the Government of Australia and the Government of New Zealand on Trans-Tasman Retirement Savings Portability, Australia-New Zealand, signed 31 May 2013 (entered into force 1 July 2013) s 11.
69 Explanatory Memorandum, Superannuation Legislation Amendment (New Zealand Arrangement) Bill 2012 (Cth) 17.
1. Expand the application of the pension exemptions under Australia’s double tax agreements to include lump sum payments in order to provide greater certainty to expatriates.

As identified above, with the exception of Hong Kong’s double tax agreements with New Zealand and the United Kingdom, all double tax agreements between the states examined in this paper only exempt ‘pension income’ without mentioning lump sum payments. The discussion above identified that under principles of tax allocation, the state in which the fund is a resident should have the right to tax both pension and lump sum benefits. In order to provide certainty for expatriates, the definition should be expanded to include lump sum payments as being taxable only in the state in which the fund is a resident.

2. The adoption of a uniform model of retirement taxation

The lack of a uniform model of retirement taxation creates difficulties with the allocation of the right to tax international transfers. Greater facilitation of international transfers would be enabled by a uniform approach as there would be greater certainty as to which state has the right to impose income tax. This would further enable the adoption of bilateral and multilateral agreements between states such as Australia and New Zealand’s Trans-Tasman agreement.

3. Elimination of international transfers

Because international transfers present the greatest difficulty in allocating the right to tax, the elimination of international transfers may be an equitable alternative. In such a situation, globally mobile employees would accrue benefits in the retirement funds of the jurisdictions in which they work and remain members of those funds on departure. The benefits would remain invested in the fund until the member’s retirement, where they could be withdrawn and taxed by the country in which the fund is resident. While this solution may avoid the problem of determining which country has the right to tax the accrued benefits of an international transfer and avoid the problem of reforming the models of retirement taxation, it does not provide a realistic solution for expatriates. Despite the increased equity in tax allocation, globally mobile employees would have their benefits split over multiple jurisdictions and may be required to submit tax returns in multiple jurisdictions and incur fees in funds that are not being actively used.

4. Adoption of international pension plans

The adoption of international pension plans may provide the benefits of avoiding the problems with allocating the right to tax in international transfers, avoid the problem of reforming the models of retirement taxation, and avoid the problem of having multiple retirement funds. International pension plans (IPPs) are retirement funds that are not tied to a specific state. IPPs are suitable for expatriates who work in a number of jurisdictions over the course of their working life. The benefit of an IPP is that the individual avoids the
fragmentation of benefits through building up retirement balances in different countries. Australia does not currently provide beneficial tax treatment to IPPs. IPPs are commonly established by multinational corporations with employers who travel frequently. According to the Mercer ‘2012 Survey of International Assignment Policies and Practices’, 63 percent of expatriates surveyed maintained in their home country retirement plans. Only 12 percent of multinational companies surveyed have established IPPs to ensure continuity of benefits for global nomads and long-term expatriates. Mercer further identified that the major limitation on the recognition of retirement plans is the challenge of apportioning taxing rights.

Apportioning a state’s right to tax an IPP may also present a number of difficulties. In providing one state a right to tax, another must naturally forego such revenue. Actuarially, a fund must be able to ascertain the proportion of benefits accrued from each state as well as differentiate the benefits based on the different treatment of benefits by each state. In recognising IPPs, Australia would be increasing the equity for migrants as well as providing an incentive for inward labour and outward retirement because the individuals are able to contribute and retire in any jurisdiction without being tied to a specific location. The adoption of IPPs in combination with greater uniformity in the models of retirement fund tax treatment may provide an optimum solution for globally mobile employees and states where they live and work, in apportioning the right to tax.

5. Adoption of multilateral treaties on retirement fund taxation

Multilateral treaties will allow greater synergy and uniformity in comparison with multiple bilateral conventions and double tax agreements. Such multilateral treaties may however be difficult to negotiate due to the competing policies of multiple states. With increased uniformity of retirement fund taxation, such multilateral treaties will be easier to negotiate and will be more beneficial to the contracting states due to less incongruence between each states’ treatment of transactions.

6. Creation of an international body governing retirement funds and international labour

In ‘Pragmatically Managing Global Migration’, Robert Blomquist weighs up the advantages and disadvantages of establishing an international body to govern and regulate global labour migration. Blomquist poses that while an international body may assist in matters such as regulating recruitment and protecting developing nations, such a body may not currently be suitable due to the incongruent policies of individual nations. An international body governing retirement funds and international labour may provide a

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71 Ibid.
72 Ibid 12.
74 Ibid.
number of benefits for creating equitable policies for the taxation treatment of expatriate’s retirement benefits. However, due to the stark differences in the structure of retirement fund taxation and policies of different nations, such a body may have a great deal of difficulty creating desirable and enforceable policies. Due to the increasing importance of retirement issues with an ageing population, there may be greater need for such a body over the next 30 years as such issues become greater policy concerns for all nations.

A Summary of recommendations: no easy solution

The expansion of the application of pension exemptions under double taxation agreements to include lump sum payments and income earned through passive investment is the only recommendation that can be undertaken in isolation. With the exception of the elimination of international transfers, the remainder of the recommendations require, or would be greatly assisted by, the adoption of uniform models of retirement taxation. The adoption of international pension plans, multilateral retirement taxation treaties and the creation of international governing bodies would all greatly assist the creation and enforcement of equity and tax allocation to both expatriates and states. The adoption of such mechanisms is greatly hindered however, by the stark differences in retirement fund taxation policies. It is clear from the problems presented that there is no easy solution to the reform of retirement taxation for globally mobile employees.

The difficulties in conforming the world’s retirement system with a globally mobile workforce is further highlighted when viewing the retirement system as a whole. The major limitation of this discussion is that it has focused solely on the synergy of private, defined-contribution pension systems in a small sample of countries. Further difficulties in allocating the right to tax and creating uniformity may arise when other private retirement systems are looked at, such as defined contribution schemes and insurance and annuity schemes. For an accurate analysis of retirement system integration, a greater number of countries than the four examined in this paper should also be investigated. The effect of global mobility on other forms of voluntary savings such as home ownership as well as the health care and government pension systems has also yet to been addressed. This discussion has therefore identified a number of concerns global mobility presents to retirement funds, however the discussion is limited by the sample and scope. There is a significant opportunity for further research to be conducted in this area and to draw upon a larger sample of countries and investigate the impact of global mobility on the other pillars of retirement savings. Furthermore, many retirement funds in other countries are government managed and controlled. These funds have not been examined for this paper but should also be considered within this context.

International mobility of labour presents a difficult dilemma for the design of retirement savings systems. While the reform of retirement funds to cater for such expatriates is not currently on the political agenda, the ageing population problems facing the world
combined with global mobility may soon see the issue gaining more prominence and importance.

V CONCLUSION

The majority of countries in the developed world are facing an ageing population due to sustained low fertility and increased life expectancy. This ageing population is identified as the major cause for projected slowing economic growth. As older workers retire, the younger generations left working will have to support the government’s aged-care expenses such as health and pension support through increased taxation. By 2060 it is predicted that there will be an average of only 1.9 workers supporting each retiree across the OECD. Governments across the world over the next 30 years will face increased fiscal strain due to these changing demographics. In order to reduce the fiscal burden following this decreased labour force participation and increased age-related spending, governments must appropriately design retirement savings systems to protect the budget, the taxpayers and the elderly.

Australia’s three-pillar approach to retirement savings utilises mandatory personal savings, voluntary personal savings and the means-tested age-pension. Mandatory and voluntary personal savings, predominately embodied in Australia’s superannuation, are privately funded and thus reduce the fiscal strain of the means-tested pension on the budget. By ensuring Australia’s superannuation system is efficient and provides appropriate economic incentives, these two pillars will therefore work towards supporting Australia’s future in the face of an ageing population.

Along with an ageing population, individuals across the world are increasingly taking up employment in foreign countries. Such international labour mobility provides a number of economic benefits for both the home and host country and may assist in stimulating the economy in light of an ageing population. Despite the internationalisation of labour, there is no consensus or uniformity regarding a model of retirement taxation. Australia’s model of retirement taxation is unique in the OECD, sitting as an outlier in comparison to other OECD nations. As a result of mobile retirees and workers and incongruous models of retirement taxation, the retirement taxation systems of the world present major difficulties in allocating taxing rights between states. This paper has identified a number of instances where the retirement fund taxation systems of Australia, Hong Kong, New Zealand and the United Kingdom have failed to provide adequate policies for expatriates and the states themselves. The major causes for these concerns are the lack of uniformity in retirement taxation models and the fact that retirees do not necessarily retire in the jurisdictions in which they work. These factors render the allocation of taxing rights and avoidance of double taxation a difficult endeavour.

In investigating a number of possible solutions to the problems global mobility presents to retirement taxation, it is clear from the problems presented that there is no easy solution to
the reform of retirement fund taxation for globally mobile employees. Furthermore, this
discussion has only focused on private pension systems which are just one aspect of
retirement savings systems, and focused on a limited sample of countries. There is
therefore much scope for further research to be undertaken in this area, which may
highlight that the inconsistencies and concerns with global mobility may extend to these
other areas of retirement savings across a broader range of countries. While the reform of
retirement funds to cater for such expatriates is not currently on the political agenda, the
ageing population problems facing the world combined with global mobility may soon see
the issue gaining greater significance.