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Re: Retirement Income Review

Mr Michael Callaghan AM PSM (Chair), Ms Carolyn Kay, and Dr Deborah Ralston.

Dear Panellists,

My submission to this Review is somewhat restricted due to health issues (temporary blindness). Please accept the fact that I have not been able to follow the exact prescribed format.

However, I believe I fully covered the four principles you proposed to use to assess the performance of Australia's retirement income system which are adequacy, equity, sustainability, and cohesion.

Please visit my above-mentioned website and refer to my submission to Joe Hockey's "Re-think" review of 2015 and in particular to the article titled 'July 24th postscript'. I also referred to the ambiguity associated with taxing the retirement accounts of low to medium wage earners in my submission to the Henry Review in 2008.

These articles demonstrate that the imposition of taxes on these accounts, namely the 15% contribution tax and the 15% tax on earnings, reduces the potential outcome by 36%. This allows the future retirees to have only 64% of what they could otherwise have achieved. This contributes to a massive future age pension costs.

Interestingly, the inverse of the above numbers shows that each future retiree could potentially have 54% extra in his or her retirement accounts.

Please also refer to 'wealth for toil or safety net dependency' article on my website. This article demonstrates the dramatic reduction in Centrelink's obligations should each and every retiree have 54% more in their accounts.

Please accept the following as my submission to the current review:

- An extract from my August 2017 Productivity Commission Review submission
- Observations, ramifications, and rectifications of the Retirement System

An extract from my August 2017 Productivity Commission Review submission:

Re Superannuation: Assessing Competitiveness and Efficiency

My reform advocacy since 1996 has been based upon the premise that variable personal taxation rates not only cause numerous inefficiencies, but upon objective analysis fail to achieve optimum results both for the government and the individual taxpayer alike.

History shows us that when certain categories of investment are given concessional treatment, intrinsic merit is overtaken by exaggerated expectations, very often doing more harm than good to both the Commonwealth and the individual investor / taxpayer.

Such is the case in regards to the current superannuation (guarantee?) system. Obviously, tax differentials are at the core of much of the dysfunction within the system.

I was employed as a Life Assurance agent between 1970 and 1978. At that time there were around 40 Life Assurance companies active in Australia, of which the top 3 or 4 wrote around 80% of the total business. The companies were mandated to invest 30% in Commonwealth Government securities and a further 20% in State Government guaranteed securities such as gas and electricity utilities.

Typically a further 20% was invested in finance company debentures such as the Australian Guarantee Corporation or the Custom Credit Corporation (Westpac and NAB subsidiaries). The remaining 30% was invested in property and shares. The objective was capital stability. Commissions were generous and accordingly competition was fierce.

Of course, the outcome for the policy holder was reduced by the high marketing costs. Ordinary life assurance premiums were tax deductible; however, the companies were subject to tax on fund earnings which had the long-term effect of reducing the maturity value by nearly 30% in comparison to a similar plan held under a superannuation trust deed.

Superannuation earnings were taxed at 5%. No tax was applied to contributions.

At this stage the following points need to be taken into account:

1. Superannuation was not compulsory; had it been so the commission structure would have been less. Obviously, a commissioned agent touting for business has a better chance of closing a deal if the prospective customer is mandated by legislation to engage in the process.
2. The process of superannuating the workforce was under way well before the introduction of the superannuation guarantee. Of course, the Military, the Commonwealth and State Public Services, Local Governing Authorities, Public Utilities, and pre-privatised entities such as Telecom (Telstra) and others made provision for their retiring workforces.

Workers engaged in industries such as Banking, Insurance, Trustee, Pastoral, etc. were well catered for as tax deductibility for such schemes was introduced in 1915. Workers engaged in other industries, where the ordinary lower ranks were not provided for, it was common for the middle rank and executive employees to be superannuated.

3. Had the superannuation guarantee not been introduced, the retirement savings industry would still have thrived. Member's entitlements would have inevitably been under more scrutiny and management from the employers and their boards of directors. No reasonable board would have allowed such costly administration and management fees to prevail.

My website deals in much detail with what I refer to as "Retrograde Taxation". I use this term to describe taxes that not only cost the taxpayer and investor good money, but simultaneously reduce

government revenue. Please refer to my response to "Better Tax / Re:Think" which Treasurer Hockey commissioned in early 2015.

The submission process was stalled as the Treasury asked respondents to comment in more detail upon superannuation. I would be pleased if the commission would take some time and effort to comprehend the section headed "July 24 Postscript", Appendixes B & C, and the two responses to Treasury re Superannuation reform (2016) at the end of the document. However, the entire document is provided as an attachment.

Please note my passing comments on death and disability insurance: "Death and disability insurance to a value that replaces Centrelink's obligation is important. However, work needs to be done by both the government and the insurance industry to create a product, that in the event of a claim, takes first call over other forms of protection such as worker's compensation, vehicular third party, boating, sport and aviation.

The consequently lower premiums would provide less drag on capital accumulation. Additionally, this initiative would also further the prospects of the NDIS being sustainable in the long run.

"The vital objective in so far as future revenue is concerned, is for the system to provide the maximum possible return at retirement for the low to medium workforce in order that the cost to Government of providing the aged pension is reduced as much as possible.

The lower paid 50% of the workforce generate only around 25% of total earnings and therefore their share of the pool will never much exceed 25%. By shifting the tax burden away from all accounts up to the level where the safety net neutrality is reached, and thereafter taxing fund earnings at 30% would over time benefit all income sectors, as well as increasing total revenue.

No contributions tax whatsoever should be applied. There is a lot to be said for not killing the goose that lays the golden egg. Lower fees and charges should be applied to accounts up to this point. Ideally fees and charges should be arranged so that final outcomes are not affected by more than 10%. Thereafter fees and charges should be allowed to reflect traditional standards common to the institutional investments sector.

Cash withdrawals that lower the account balance to the point of future social security dependency should not be entertained. The Winnebago can wait! Salary sacrifice should be supported and encouraged only to the extent that, by actuarial projection, safety net neutrality is reached, and not beyond.

The Howard / Costello Lump Sum 'initiatives' of 2006 have ended up as an arbitrage mechanism. There was no liberalism present in allowing preferential tax treatment for people with a spare million dollars, in the name of superannuation. This million dollars far exceeded the aged pension thresholds both in terms of asset value and income potential.

The one million very often became two in the case of couples. Nor was there any social engineering or socialism present. Even compassionate conservatism was absent. Perhaps there was some non-compassionate conservatism coupled with agrarian socialism in evidence! It is simply untrue to say to the taxpayer / investor with a spare \$1.6m that he or she deserves no consideration from the taxation system as in the vast majority of cases somebody has worked very hard or been very smart to be in that position.

However no properly designed system should encourage arbitrage, because every act of arbitrage costs everybody else money. The real consideration that is warranted is the abolition of the two

highest personal income tax rates. This will benefit all expenditure and investment decision that such a person makes, reducing the perceived need to engage in loop-holes.

The size and scale of the superannuation system alone is sufficient reason for a uniform taxation system. At between 0% and 50% we have five rates of tax. Comparative yield rates vary in each bracket. It is the lowest paid who receive the lowest comparative yield, yet they are the people who need it most. In fact, they are the people for whom the system was designed for in the first instance.

The Commonwealth itself was meant to be a major beneficiary through slashing aged pension liability. The current state of play does only half the job, if that. The initial costs associated with reform are no excuse for delay, as a reformed system will pay dividends forever. In this current revenue negative setting, funding reform may have to come from outside the square. Try the Futures Fund; they have the capacity and collateral to bridge short term shortfalls.

Observations, ramifications, and rectifications of the Retirement System

1. The Productivity Commission's assessment of the superannuation system has drawn attention to the negative effects of issues such as UNSUITABLE INSURANCE (14%), UNDERPERFORMING FUNDS (45%), HIGH FEE FUNDS (12%), & MULTIPLE ACCOUNTS (6%). However, the Commission did not take into account the negative effects of taxation which retard all retirement accounts by around 36%. This means that future retirees potentially would have been in receipt of around 54% more which would dramatically reduce Centrelink's responsibilities. It is a gross oversight by previous legislators. There are few measures more counterproductive than taxing the retirement accounts of those who subsequently will become social security recipients.

2. Apart from the house-keeping and administrative issues listed in paragraph 1, there is an error in fiscal design which deprives future generations of retirees from achieving an optimal result in their retirement accounts. (See above mentioned 'Wealth for Toil' article on my website)

3. The obvious solution is to abolish all taxes on retirement accounts until either the level of social security neutrality is approached, or otherwise a clearly defined "reasonable retirement benefit" is established, thereafter taxing (earnings only) at twice the current 15% rate. With the 15% contributions tax removed, net contributions increase by 17.65%. With fund earnings no longer taxed at 15%, a typical current yield of 7% will equate to a real return of 8.2%. (See above mentioned 'Wealth for Toil' article on my website) In other words, future retirees could receive an extra 54% in their accounts.

4. Such measures should bring to conclusion the repetitious 'clarion call' over time for the contributions to increase to 12%; $9.5 \times 1.56 = 14.82$ significantly surpassing the objective of the 12% argument and virtually reaching the aspirations of those who have advocated a 15% SG. This can be achieved just by shifting the tax points.

5*. High income earners enjoy a tax deduction of 45% less 15% contribution tax = 30%. This brings about a loading of over 40%. (30 divided by 70 gives a 42.85% loading). Whereas those on a modest income might pay less than 15% tax, thereby receiving no such loading. Very serious consideration should be given to changing marginal deductions to a 25% REBATE for all. After all this still constitutes a discount of 33%. Obviously, the SG must be quarantined from the negative effects of so called "progressive" taxation in the National interest.

6. Transitional costs may seem challenging in terms of budget sensitivity. However, what would be the cost to the consumer economy, over time, if the SG contributions grew to 15% to achieve similar outcomes? 5.5% loss of disposable income year on year. Thirty years from now the total assets under management could easily be 25% higher than under the current arrangements just through shifting the tax points, and the total revenue under this proposal will be much higher in the long term, as the cost of aged care and pensions will diminish significantly.

7. There are many avenues for funding any immediate transitional shortfall over the four year (and ten year) forward estimates without impacting the budget bottom line. A bond issue to either the Futures Fund or the larger Super Funds deserves consideration. After all, the transitional "costs" should be seen as an investment which will pay dividends forever.

8. Death and disability insurance, to the value that either replaces Centrelink's obligation or provides an amount equivalent to a "reasonable retirement benefit", is desirable provided, of course, it is cost effectively achieved. However, work needs to be done by both the government and the insurance industry to create a product that, in the event of a claim, takes first call over higher risk forms of compensation such as workers' compensation, vehicular third party, boating, sports, and aviation etc. Consequently, lower premiums would cause less drag on capital accumulation.

9*. Much of the mayhem within the compulsory superannuation system is the product of an obsolete "progressive" personal income tax system which does little for the people most in need whilst providing well for those who don't really need it. Parliamentarians for decades seem to have overlooked this fact which otherwise would give relief to the aged care budget going into the future. Even if the government or future governments never get around to abolishing the top two marginal rates, tax deductibility should be quarantined from the effects of various rates, producing an equitable and uniform return for all, as in para 5.

10*. The Howard/Costello 2006 introduction of Lump Sum single or staggered deposit contribution was not well thought out. A person with a spare \$1,000,000, or a couple with a spare \$2,000,000 were never to be in the position of qualifying for the aged pension as the asset test for a couple even now is only \$375,000. So, there was no intrinsic benefit in overriding more deserving or pressing aged care priorities.

11. The combined revenues of the Commonwealth, States and Territories is around \$600B. Reported recently in The Australian newspaper, the revenue foregone in the subsidising of superannuation is four times that of the total Aged Care and pension budget; \$200B (1/3 approximately).

12. Overdosing on tax deductible investment is more often than not counterproductive both for the individual taxpayer/investor and government revenue. Such over utilisation should never be tolerated; but sadly, it has been (through shabby association with vested interests, together with perceived electoral benefits).

13*. The Federal Opposition's proposal to change imputation credits is only flawed in that it is like turning water off at the nozzle instead of at the tap. The top two marginal rates are door openers to arbitrage. The question must always be asked: is it a retirement account or is it an arbitrage account exchanging 45%, 37% or 32.5% for a 15% rate? It seems obvious that those who claim to be big losers under the opposition's proposal have in fact enjoyed at least a decade being beneficiaries of errors occurring through the Howard/Costello era. Can it really be called a retirement account if the sum invested is only a fraction of a high net worth individual's investment portfolio? I should

imagine that most such people would gladly surrender their ability to arbitrage their portfolio in exchange for the abolition of the top two marginal rates.

14*. Lump sum deposits up to the aged pension asset test limit should receive tax free status (0%), and thereafter be taxed at 30% instead of the current 15%. This would produce a better outcome for all accounts up to \$750,000 and mitigate some of the costly effects of arbitrage. It should not be the Government's role to assist high net worth individuals in this particular manner. Greater benefits would flow across the board if the top two marginal rates were set aside. However, it is well within good governance to incentivise or reward those of average means to retire independently of social security.

15. Whilst the reforms raised concerning the Superannuation Guarantee in paragraphs 1-9 point to very substantial transitional costs over the next few years, the dividends over the longer term are considerable, particularly for the children and grandchildren of the likes of those who complain about the imputation credits issue. However, the transitional period can be seen as much shorter to fund if most of the existing lump sum arbitrage loop holes were to cease.

16. Good tax architecture must be conducted in a spirit of bi-partisanship. The matters herein warrant urgent reform. Both government and opposition must respond in the affirmative.

* These paragraphs are extracts from an article I wrote over 12 months ago before the current government's amendments to the tax rates. My eyesight does not permit me to upgrade these paragraphs, however I have included these because they are still of substantial merit.

17. The concepts of giving low income tax offsets and superannuation co-payments are flawed. A large percentage of low-income earners are students working their way through university with prospects of having an affluent career. Many more are spouses of high-income earners. For example, I once employed a lady as a part-time personal assistant who was the spouse of fully superannuated retired parliamentarian. She proudly informed me that she had received a superannuation co-payment and a low-income tax offset. Given that her spouse was probably on pension of around \$100,000 p.a., I thought that the receipt of such monies by such a person was an inappropriate use of public money.

18. It is often commented on in the media that women, due to child bearing, raising children and grand parenting, accumulate very little in their superannuation accounts because they are out of the workforce for such lengthy periods. I believe the superannuation system should not be convoluted by any minority and the Centrelink Safety Net should suffice ethically and morally. Here again many such women are spouses of affluent retirees.

19. Early withdraws from Super accounts should not be entertained whereby the account balance drops below the reasonable retirement benefit or Centrelink neutrality.

20. Often there is discussion concerning the utilisation of superannuation accounts for the purpose of assisting 1st home buyers. Whilst I don't agree with much of what the advocates state, I believe there could be a case made for releasing the balances which have accrued up until the 25th birthday in the case of each partner. This still leaves over 40 years of accumulation at adult wages.

21. Investment earnings by retirees should be taxed at 30% from the 1st dollar providing their superannuation account and private savings exceed the social security dependency threshold. Whereas personal exertion earnings should attract normal tax free and low rate thresholds.

E.&O.E.

I thank the treasury for the opportunity of airing my views. I believe that my reform suggestions deserve very serious consideration.

Yours faithfully,

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