Complex and unfair – our retirement system needs simplifying

Theo Marinis explains why Australia's retirement system is unfair, as its complexity often forces investors to pay considerable fees for expert advice.

Recent hip replacement surgery has given me time to reflect on many things, but none more so than the complex interface of our superannuation/taxation/social security system – with its inbuilt tax traps, penalties, and inherent unfairness.

Many successful investors are highly competent, and whilst they may not have all the finely nuanced detail at their fingertips, they generally have a good overall understanding of the retirement investment environment.

However, they are rarely able to navigate the complexities without being forced to employ a range of experts, and to pay considerably for the service.

The trend from our legislators (via the public service) and the advice industry is more and more towards complexity – and I fear that is changing the power dynamic.

Within this culture of complexity, there are opportunities for arbitrage which can be missed by the uninitiated.

Take, for example, the 15 per cent (plus Medicare levy) death benefits tax applied to the unused portion of superannuation benefits.

A simple ‘cash out and recontribution’ strategy will remove this liability – provided it is implemented while you are still alive and eligible to access and contribute to superannuation. Taking this action can deliver a saving of almost 20 per cent to your estate, and this tax on death benefits can effectively become an ‘optional’ tax.

Without a professional ‘codebreaker’ even the most astute can struggle.

Then there are the warnings surfacing from the ATO around excess transfer balance cap (TBC) issues arising from reduced pension account values.

The ATO is concerned that some SMSF trustees and super fund members don’t fully understand how the credits and debits in their transfer balance accounts operate – with the consequence that they are at risk of inadvertently breaching their TBC by topping up pension accounts which have seen balances reduced in the current COVID-19 environment.

To a ‘non-expert’, the logical approach to a pension which commenced with a value of $1.5 million (which is today now worth only $1.2 million) topped up with, say, $300,000 from funds remaining in accumulation phase, is that it should still be within their transfer balance cap of $1.6 million. Instead, this ‘new’ pension of $1.5 million is now in excess of their transfer balance cap by $200,000.

The result? The ATO will offer you one of two unpleasant and cumbersome bureaucratic “options”:

Option 1: Leave the excess amount in super and pay 47 per cent tax on this excess; or

Option 2: Release the excess from your super funds and amend your personal tax return to include the associated earnings on the excess amount in your personal taxable income.

Who knew? Well, only an expert.

As witnessed firsthand from my days at the ATO, Centrelink and the ISC (what I call my apprenticeship for my current role), many public servants thrive on the complexity arising from political thought bubbles. They then turn this into legislation which is always complex, two-dimensional, and fraught with potential pitfalls.

In turn, this provides the ‘financial engineers’ in our midst with the potential to thrive. They get to keep on going back to milk the investment cow by setting up strategies that only they really comprehend.

So, what specifically can we learn from this complexity, other than it is not good?

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Avoid tax-driven get-rich schemes – they always come undone. Avoid over-engineering your finances and having to pay exorbitant fees to a financial 'engineer' to keep the schemes afloat and look for legal (and ethical) arbitrages.

Trusts, self-managed super funds, family company structures, negative gearing etc, all have a place, but in my view, tax-driven investing is both expensive and fraught with risk. We all remember the airline pilots with their Medicare health cards, the 'bottom of the harbour' investors, the tree plantations… they all ended in pain.

Start with a professional team, a financial adviser, a lawyer, and an accountant – meet with them as a group with a clear brief to avoid the creation of excessively complex arrangements.

During recent hip replacement surgery, I had the good fortune to observe professional teamwork from another perspective. My orthopaedic surgeon – one of (if not) the best in his field, had in place a 'best of breed' team of professionals to assist him, including an outstanding surgical team, an excellent anaesthetist, as well as the hospital, nursing staff and post-op physiotherapy team (with whom I'm still working). The combination made the whole process remarkably, relatively pain-free and an ALMOST pleasant experience!

Similarly, having a good financial advisory team is so important – good people, working to a clear brief, will usually compete to outperform, and that's what you deserve. They will also act as checks and balances to each other.

A better and fairer system would be one which is characterised by clarity and simplicity. Financial advisers should be guiding their clients through an investment strategy, not a minefield of legislation.

I would like to see our politicians enter into a bi-partisan agreement to halt changes to legislation for a period of say, three years. Grandfather all previous arrangements to ensure that no investor is disadvantaged, and consult with industry advocates and professionals, not the Australian Public Service (whose role should be administrative) in the process to achieve a common-sense approach to the simplification of our superannuation, taxation, and investment system.

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