SUBMISSSION TO TREASURY: WHITE PAPER 'BETTER TAX' REVIEW

PETER MAIR

HIDDEN TAXES IN RETAIL BANKING

UNLEGISLATED – UNWRITTEN – UNSEEN – UNSPOKEN

Preamble

One never knows how much it is worth investing in a contribution to a process that will eventually be decided on essentially political ramifications rather than any intrinsic merits of reform proposals suggested and possibly even recommended by the review.

Pre-eminence of political realities is understandable enough even it is unfortunate that these realities can have a party-political bias, recently with tones akin to class warfare.

It is especially disappointing that a once blank canvas is now rent with ruled-out options and pre-emptive commitments to making 'no change' to problematic tax policy settings.

What follows has a deliberately limited perspective – hidden taxes in retail banking operations -- very obvious shortcomings in de-facto tax policy settings which have not only long had bi-partisan support, presumably, but are otherwise 'unlegislated' , 'unwritten', 'unseen' and 'unspoken' . Conversely, the politicians may never have been told clearly.

Established acceptance reasonably denies a defence of 'unintended consequences' -- there is nothing unintended about the easily understood consequences, however inappropriate they may be.

As things stand, however, these taxes are apparently untouchable – never mentioned by the regulators nominally responsible for correcting them and routinely ignored by other inquiries which might be expected to discuss and explain them even if they do not propose reforms to deal with them.

That no-one says anything is a warning sign.

Does this fit with the declared review agenda?

In my mind the exposure of these issues would have clear resonance with many of the catch-phrases nominated in the discussion questions proposed for the review.

An illustrative selection includes:

--- *fundamental change, boost economic growth, maintaining fairness, fringe benefits, tax and transfer system, tax offsets, bank accounts and debt instruments held by individuals, taxation of domestic savings, tax avoidance practices, encourage investment in innovation, particular concerns about competitive advantage, deliver taxes that are lower, simpler, fairer?*

Whatever the most sensible approach may eventually be, for the moment it seems to me to be sensible to simply incorporate here illustrative and explanatory extracts of my concerns drawn from recent submissions to public inquiries and official reviews – and then to wait for a response from the review team which, depending, might invite an additional submission, possibly following a discussion to clarify questions of practical relevance.

EXTRACT 1: SUBMISSION TO FINANCIAL SYSTEM INQUIRY / 2014 / MAIR

REGULATORY FAILURE & REGULATORY REFORM

destructive bartering of 'free services' for 'free deposits'

Anyone wondering why four bank-conglomerates now dominate the Australian financial system need go no further than a simple explanation which the RBA is apparently unable to acknowledge.

Allowing major-bank, tax-avoiding, bartering of 'free' services for 'interest free' deposits is fundamentally disruptive – it was dramatically destructive of the competitive environment in the late 1980s when 'all' the new foreign banks failed along with 'all' the long-established state banks. Subsequently the major-banks took over of 'all' the new building-society banks.

One corollary is that, while this fundamental 'barter' flaw remains, there is no credible prospect of viable new retail banks being established. No credible prospect – none!

Another is that the efficiency of the retail payments system is and remains compromised without prices reflecting costs, especially when the associated cross-subsidies are allocated perversely – e.g. to support costly cheque payment facilities provided 'free'. Such barter-revenue distortions have sadly denied, for decades, sound person-to-person direct-transfer facilities.

The RBA could and should have dealt with this disruption of competition and efficiency – it did not – it does not even acknowledge its relevance. When pressed, however, the RBA says it was not, and is not, its job to seek the coordination of tax-policy settings that are unfairly disruptive.

One simple, sensible and realistic reform would see the ATO require banks to advise transaction-account customers of taxable interest income 'deemed' to have been paid on daily deposit balances on which less than a market interest rate is paid. This 'deeming' policy approach is well established in means-tested entitlements to pensions and social security payments.

One attraction of this approach now is that the current low-interest rate environment is uniquely favourable to making the change – this reform would preclude a repeat of the destructive disruption of tax-free barter when interest rates are higher (e.g. the 15% p.a.+ in the 1980s). There would also be a stimulus to competition and efficiency in retail payment systems.

The abject failure of the RBA to understand these market realities in the 1980s is never mentioned in polite company. One can only wonder what an edited 'history' will say.

The RBA has been more generally derelict in its failure to regulate the retail payments system – a responsibility first formally allocated 30 years ago and given formal legislative endorsement in 1998. The RBA has never mustered the 'independence' to explain frankly how the retail banking and payments system works – why it is inefficient and why there is only ever less competition. That is a denial of the 'independence' the community is entitled to expect.

'free banking' is a costly illusion

An apparently immovable foundation stone of 'political' banking-policy is that Australians are more or less entitled to unlimited banking services essentially 'free of charge' -- and one problem is that, in the misled mind of most Australians, this entitlement is essentially delivered.

Practically, of course, this is not true[1] -- 'free-banking' is a very costly, efficiency sapping illusion.

The vocal political objection doubles the deception: only bank fees that can be clearly seen by customers are 'objectionable' and best avoided or otherwise kept very low. Conversely, the sky is the limit if customers are unable to understand and clearly 'see' high transaction and account keeping fees deceptively hidden in obscure complex pricing arrangements.

The real cost of the deceptive political attachment to free banking is untold – and deliberately untold by the RBA.

Consider the 'cost' of key elements in the overall deceptive illusion.

Customers are not paid a market rate of interest on their daily balances on deposit in transaction accounts but banks earn a market rate when lending those funds -- hundreds of billions in bank deposit accounts -- $900 billions+ presently -- are denied billions in interest 'not paid'. Banks use part of those soft net earnings to subsidise the cost of providing services free-of-charge.

One inequity here is that banks do not account for how that 'endowment' of soft income is spent -- another is that no tax is paid on the personal interest income not paid, so the national treasury is left short of about one-third of the interest not-paid to individuals[2].

What's worse, these perverse outcomes take away the very competitive incentives that customers and their banks should have to choose, and provide, the lowest cost services. Cheques, for example, are still only too slowly being made redundant and person-to-person electronic transfers have been too long denied.

[1] Lest we get lost in semantics, fees charged explicitly but below full cost have a substantial 'free' component.
[2] The RBA does not disclose the interest not paid by banks – some $billions p.a. -- nor ask banks to account for the disbursement of earnings on the investment of those 'free' funds.

The overcharging racket banks run with credit cards beggars belief – and it has only partly been brought to book. Customers, told that credit card transactions are 'free of charge', do not see that behind the facade the retailers pay high fees as a % of purchase values.

One can only wonder if politicians would not demand action if they were clearly told of these deceptions – perhaps the panel could propose that a full and frank exposition be made of the workings of the retail banking and payments system.

The community and the parliament could at least be given the full facts on which to base preferences for continuing, or not, the illusion of 'free banking'.

A community given scant sympathy for ever higher energy and utility bills, could surely cope with the (low) explicit fees that would be appropriate for efficient electronic transaction services

[Some people, known to be needy – like pensioners -- are reasonably entitled to have access to basic banking services free of charge. The sensible way to ensure this would cover the cost of providing basic banking to the needy from the commonwealth budget – and the cost would be contained by putting the business to competitive tender from banks.][3]

EXTRACT 2: FINANCIAL SYSTEM INQUIRY: SECOND-ROUND SUBMISSION

REGULATORY FAILURE -- IS REGULATORY REFORM TO BE DENIED?

STRIKE TWO: IT'S TIME FOR PLAIN TALK

'Hidden' regulation – never mentioned, secretly buried but still very effective

As a day-to-day practicality it is fair to say that some little known regulations are affecting the retail financial system in ways that perversely underwrite the dominance of the banking conglomerates known as the 4Pillars.

These are the regulations which the 4Pillars never want repealed.

(i) the bartering tax break

[3] The courts are currently reviewing the legitimacy of a myriad of so-called 'exception fees' that banks impose as punishment for inadvertent customer mistakes usually of no consequence in long-term relationships -- e.g. overdrawing of accounts or late payments.

In the normal course the Tax Office would take a dim view of commercial arrangements to deliver something valuable 'for nothing' while actually giving valuable 'income in kind' that is 'not declared' and not subject to income-tax. Banks do this with their customers routinely – valuable transaction services are provided 'free' (or underpriced) in exchange for 'free' (non-interest bearing) deposits in transaction accounts – currently some $900 billion+.

Not only is the associated tax-avoiding rorting of the public purse offensive in itself but more so are the consequences of allowing the 4Pillars to do this. Banks' soft earnings on the 'free deposits' – overwhelmingly the 4Pillars -- far exceed any cross-subsidizing 'loss' on underpriced retail payments services. The leftover 'surplus' in turn feeds the 4Pillars' ammunition box which finances destructive 'competitive' attacks on erstwhile competitors. With the high interest rates of the late 1980s, this process wiped out the then new foreign banks, the state banks and, soon after, the crossover building society banks.

There is a reason why the 4Pillars have an unassailably dominant position -- but 'no one' explains. The eventual contribution of the Murray Committee will be deficient if it does not.

EXTRACT 3: SUBMISSION TO RESERVE BANK REVIEW OF CARD PAYMENTS REGULATION

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Whatever, one cannot also help thinking that it suits the banking regulators to allow banks to have access to these excessively profitable arrangements at the expense of the wider community. Viewed in this light, the racket becomes almost a de facto enhancement of the capital of the banking system. Put differently, allowing the credit card racket to continue endorses a discretionary regulated 'tax' unfairly imposed on the community without any justification – a tax imposed by a self-declared 'reluctant regulator' but one not owning up to being a reluctant de-regulator and corrector of unintended consequences of other regulatory shortcomings.

This thinking is only endorsed by the associated appalling regulatory nonsense that allows major banks 'alone' to engage in bartering arrangements – free transactions for interest free deposits – at the massive expense of sustaining an insurmountable barrier to entry to 'new banks' and ensuring the 'death by takeover' of any erstwhile competitor with pretensions to viability.

This 'no'-cost deposit base is now running towards one trillion dollars.

Why is retail banking run like a cartel? -- Banking regulators also like it like that, apparently.

.....and that, so far, says nothing of related consequences -- the now substantial (and, at times, massive) tax evasion associated with the not-taxed, income-in-kind of underpriced services; the misuse of associated excessive profits in retail banking to plunder wealth-management and other business opportunities; the predictable inefficiency of a retail payments system operating so perversely without any semblance of explicit cost-based prices.

Australia is paying a high price for the privilege of its major banks and banking regulators enjoying the quiet life of operating and overseeing a commercial cartel protected by discretionary de facto regulation that is ‘unlegislated’, ‘unwritten’, ‘unseen’, and ‘unspoken’.

Australia is not alone: consumers globally are routinely abused by banking arrangements and regulatory settings that are similarly exploitative and nonsensical.

What happened to ideals of regulatory integrity?

ENDING REMARKS

I trust the foregoing is enough to register the gist of a tax-policy issue which I would like to see addressed.

I am happy to discuss and elaborate the exposition.

Peter Mair

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