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Implications of removing refundable franking credits

Introduction

2.1 Much of the debate around the Australian Labor Party (ALP)'s policy to remove refundable franking credits has focussed on whether it is fair. Supporters of the policy argue it is necessary to make the Budget sustainable and that it will mainly affect wealthy Australians who can afford to make a bigger contribution.[1]

2.2 However, many retirees and other investors dispute the idea that recipients of franking credit refunds are wealthy and say the policy is unfair and inequitable.

2.3 The Parliamentary Budget Office (PBO) estimates revenue from the ALP's policy would be $5.2 billion in 2020-21, increasing to a total of $48.6 billion by 2027-28.[2]

2.4 This chapter examines the implications of removing refundable franking credits, beginning with the PBO's modelling of the financial implications for those affected by the ALP's policy. Claims the ALP's policy will affect people on modest incomes and the increased stress and complexity the policy would cause for Australians to adjust their investments are examined. A number of unintended consequences have been raised and are discussed, including claims the ALP's policy may increase

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1 Grattan Institute, *Submission 435*, pp. 3-8, pp. 10-11; The Australia Institute, *Submission 410*, p. 15; *Industry Super Australia*, Submission 414, p. 11. Australian Council of Social Service, *Submission 431*, p. 2.

2 PBO, Policy Costing, *Dividend imputation credit refunds*, PR18/00145, p. 3; p. 6. The PBO noted the policy would 'be expected to result in an increase in departmental expenses of $2 million in 2018-19 and $1 million in 2019-20' (p. 3).

dependence on the Age Pension and may negatively affect the value of Australian shares and investment in Australian companies.

2.5 While many submissions argued the ALP's policy should be rejected outright, options have been proposed to modify the policy and are examined, including capping refunds, grandfathering existing arrangements and delaying the policy start date.

2.6 The committee heard a large number of personal stories and concerns about the removal of refundable franking credits. Selections of these statements are included in text boxes to show how some people claim they will be affected.

PBO distributional analysis of refundable franking credits

2.7 The PBO's costing, reproduced at Appendix E, provides a distributional analysis of the number of individuals and superannuation funds who would be directly affected in 2019-20 and an analysis of individuals and superannuation funds in 2014-15.

2.8 Table 2.1 provides the PBO's distributional analysis of individuals directly affected by the policy, based on 2014-15 data.

Table 2.1 Individuals - Distribution by taxable income in 2014-15[(a)]

Decile[(b)]	Taxable income range	Number of individuals claiming excess franking credits	Percentage claiming excess franking credits	Average excess franking credits claimed ($)[(c)]	Total excess franking credits claimed ($m)[(d)]
1	Under $9,500	403,700	29.5%	640	258.8
2	$9500 to $19,000	267,700	19.3%	990	266.3
3	$19,000 to $26,400	198,700	14.3%	1,580	312.9
4	$26,400 to $35,000	112,900	8.1%	2,980	336.6
5	$35,000 to $43,200	53,200	3.8%	4,430	236.1
6	$43,200 to $52,500	24,200	1.7%	4,670	112.8
7	$52,500 to $64,400	17,000	1.2%	5,040	85.7
8	$64,400 to $80,200	22,500	1.6%	6,030	136.0
9	$80,200 to $109,600	16,100	1.2%	5,980	96.0
10	$109,600 and over	16,300	1.2%	11,880	193.8
Total individual taxpayers		1,132,300	8.1%	1,800	2,035.1

Source *PBO, Policy Costing, Dividend imputation credit refunds, PR18/00145, p.10.*

Notes *(a) Figures may not sum to totals due to rounding; (b) Based on the income of all taxpayers in 2014-15; (c) Calculated as the average franking credit refund of those individuals who received a refund in 2014-15; (d) Calculated as the number claiming excess franking credits multiplied by the average excess franking credits claimed.*

2.9 The PBO estimated that in 2019-20, excluding Australian government pension and allowance recipients, the policy would affect:

- 840,000 individual taxpayers
- 210,000 self-managed superannuation funds (SMSFs), and
- 2,300 Australian Prudential Regulation Authority (APRA) regulated funds, including industry and retail funds.[3]

2.10 Table 2.2 provides the PBO's distributional analysis of SMSFs directly affected by the policy, by fund balance, based on 2014-15 data.

Table 2.2 SMSFs – Distribution by fund balance in 2014-15[(a)]

Decile[(b)]	Fund balance range	Number of funds claiming excess franking credits	Percentage claiming excess franking credits	Average excess franking credits claimed ($)[(c)]	Total excess franking credits claimed ($m)[(d)]
1	$0 to $90,276	8,616	17.90%	1,391	12
2	$90,277 to $181,089	9,503	19.80%	1,137	10.8
3	$181,090 to $279,252	11,866	24.70%	1,900	22.5
4	$279,253 to $402,090	15,349	31.90%	2,890	44.4
5	$402,091 to $558,140	18,554	38.60%	4,088	75.8
6	$558,141 to $762,242	21,902	45.50%	5,611	122.9
7	$762,243 to $1,044,621	24,734	51.40%	7,532	186.3
8	$1,044,622 to $1,497,218	27,208	56.50%	10,468	284.8
9	$1,497,219 to $2,443,843	29,946	62.20%	15,652	468.7
10	$2,443,843 and over	33,761	70.20%	40,468	1,366.20
Total SMSFs		201,439	41.9%	12,880	2,594.5

Source *PBO, Policy Costing, Dividend imputation credit refunds, PR18/00145, p.11.*

Notes *(a) Figures may not sum to totals due to rounding; (b) Based on the fund balance of all self-managed superannuation funds in 2014-15; (c) Calculated as the average franking credit refund of those funds who received a refund in 2014-15; (d) Calculated as the number claiming excess franking credits multiplied by the average excess franking credits claimed.*

2.11 It is accepted that the 2014-15 distributional data is out of date because it does not reflect the introduction of the $1.6m transfer balance cap on 1 July 2017. This change limited the total amount of superannuation that can be transferred into the retirement phase.

3 PBO, Policy Costing, *Dividend imputation credit refunds*, PR18/00145, pp. 9-10.

Box 1: Personal accounts of how the policy may affect some individuals

'How can Australians plan their retirement when the goalposts are constantly being changed for the worse and the playing field is so far from level that it is unfair?' (Sam Linnell, *Transcript*, 26 February 2019, Norwood, p. 18)

'Both my wife and I are self-funded retirees, like a lot of other people here. We're not retired millionaires, nor are we from the so-called big end of town. We are ordinary Australians who have worked hard, paid our taxes and saved as much as possible for what we hoped would be a comfortable retirement. We now find ourselves confronted with this unfair and discriminatory proposed new retiree's tax. What is most unfair about it is that it is a retrospective tax; it adversely affects decisions people like us and many others made many, many years ago.' (Ron Hicks, *Transcript*, 8 February 2019, Chatswood, p. 4)

'It is our money. We worked and paid taxes to support the elderly and now we should receive the same consideration. Time does not allow us to change financial arrangements that were carefully planned over 40 years ago. This should not be violated.' (Pamela Alvarez, *Transcript*, 8 February 2019, Chatswood, p.8)

'The ALP's plan to disallow franking credit refunds will have its greatest impact on older women—me being almost 92. Not only do older women claim the greatest number of franking credits as a group by age and gender, but they are also more likely to have little or no superannuation to fall back on.' (Jo George, *Transcript*, 25 February 2019, Carlisle, p. 3)

'My income currently is very low. I am actually entitled to a low-income card. That of course gives me no rewards financially. Basically, I'm living off the money that we saved, because my income at the moment is far less than what a pensioner earns. Is that the reward that you get for hard work in Australia?' (Jan Hollingsworth, *Transcript*, 25 February 2019, Carlisle, p. 10)

'We believe the policy as proposed by Labor is wholly inequitable and discriminates against certain segments of the community. This is an attack on the elderly Australians who have helped build this nation to be what it is today. We in Australia talk about fairness. This policy is unfair and very Australian.' (Ian Moller, *Transcript*, 25 February 2019, Carlisle, p. 9)

'My husband was a truck driver and worked in a factory. I worked with children and adults with disability. When my mother left me money, I thought, "That's lovely. Now I don't have to depend on the government." It looks like I probably will have to. How do you think I feel, especially when it's such an unfair tax, that we're taxed twice?' (Jenny Hopper, *Transcript*, 8 February 2019, Chatswood, p. 4)

Income profile of recipients

2.12 Many individuals and stakeholders highlighted the unfairness of the ALP's proposal to remove refundable franking credits and did not view the existing dividend imputation system as being inequitable.

2.13 National Seniors Australia remarked that self-funded retirees are not 'a homogenous group' and reported many 'are subsisting on relatively low-incomes with limited access to financial support in the form of subsidised health care or concessions on essential services.'[4]

2.14 The Alliance for a Fairer Retirement System (the Alliance) provided analysis showing that, in 2014-15, over half of those receiving cash refunds for their franking credits had incomes below the $18,201 tax-free threshold of the time, and 96 per cent had taxable incomes of less than $87,000.[5]

2.15 The Self-Managed Superannuation Fund Association argued the ALP's proposal represents 'poor policy', because:

- low rate taxpayers will effectively be paying a higher tax on their dividends through the loss of franking credits, and
- individuals on higher taxable incomes will not lose the benefit of franking credits.[6]

2.16 The Alliance remarked that older women could be especially disadvantaged by the ALP's policy and that this would be concerning because older women are less likely to have adequate superannuation balances to fall back on.[7] The Alliance noted that the policy has also been referred to as a 'widow's tax', and explained:

> Some people have referred to it as a widows' tax in that elderly women who have been left a bundle of blue-chip shares, which is quite often the case with older retail investors, are living on that income without being fully aware of where that income is going, and having very little capacity to reorganise their financial affairs.[8]

4 National Seniors Australia, *Submission 421*, p. 3.

5 Alliance for a Fairer Retirement System, *Submission 411*, Attachment A - 'Alliance Fact Sheet', p. 1.

6 Self-Managed Superannuation Fund Association, *Submission 420*, p. 4.

7 Professor Deborah Ralston, Chair, Alliance for a Fairer Retirement System, *Transcript*, 20 November 2018, Sydney, pp. 10-1.

8 Professor Deborah Ralston, Chair, Alliance for a Fairer Retirement System, *Transcript*, 20 November 2018, Sydney, p. 11.

2.17 Plato Investment Management Limited said the ALP's policy would 'regressively impact self-funded retirees investing directly or via SMSFs, and other low-income individuals', and explained:

> Our modelling shows how those on the lowest incomes/ lowest investment balances are likely to lose the most in terms of percentage of income. This is particularly the case for direct investing self-funded retirees with the lowest taxable incomes, who are expected to lose the most in both absolute dollar and percentage of income terms.[9]

2.18 By contrast, the Australian Council of Social Service (ACOSS) support the ALP's policy and argued that taxable income is a poor indicator of a person's wealth:

> As to who this would affect, there's quite a bit of confusion, I think, because much of the discussion is about taxable income. Taxable income gives no indication of the capacity-to-pay people in that zero-tax, post-retirement environment.
>
> According to the PBO, a large share of the revenue that would be gained from this measure—the removal of imputation credit refunds—if it were implemented, would come from the top 20 per cent of SMSFs by assets which have balances of $1 million and above.[10]

Possible increased dependence on the pension

2.19 The potential for the ALP's policy to increase dependence on the Age Pension was a common concern among those who made submissions or provided statements to the committee at the public hearings.

2.20 The Australian Shareholders' Association (ASA) claimed the ALP's policy will force many self-funded retirees onto the Age Pension and argued this 'defeats the purpose of the policy which is to decrease government expenditure.'[11] The ASA stated:

> For some retirees, a decrease in franking income will result in an increase in their self-funded pension payments, which will diminish the capital available to support their self-funded

9 Plato Investment Management Limited, *Submission 407*, p. 1.

10 Dr Peter Davidson, Senior Adviser, Australian Council of Social Service, *Transcript*, 30 November 2018, Dee Why, New South Wales, p. 9.

11 Australian Shareholders' Association, *Submission 119*, p. 4.

> retirement, and more self-funded retirees would therefore start to rely on a part Age Pension sooner. [12]

2.21 Others argued the ALP's policy will create an incentive for retirees to draw down on capital in order to qualify for the Age Pension. Plato Investment Management Limited said:

> Our modelling also indicates that there will be considerable incentive for self-funded retirees who are up to $200,000 ($400,000) above the current pension assets tax maximum for singles (couples) to spend those excess assets in order to qualify for a part pension and a full refund of franking credits.[13]

2.22 SMSF retiree Mr Russell Picton commented:

> Since we retired, we have lost the part-pension, due to the current government altering the assets test limits. Now, when Labor takes over, we will lose our imputation credits because we are no longer pensioners. If they continue chipping away at our self-funding efforts, we may end up on the pension, which they don't want us to be on. This does not make any sense at all. If we want to reduce our assets to get on the pension, we are restricted to $30,000 for our family over a five-year period. But if we go on a world holiday and spend one-half of our assets overseas, which is no good for Australia's economy, we're then under the assets test limit, which enables us to get on the pension.[14]

2.23 The Grattan Institute disputed the idea that retirees would draw down on assets to qualify for income support and said 'the analysis we've done suggests, if anything, that people are net savers in retirement'. The Grattan Institute explained:

> Average people in their 70s have more wealth than when they were in their mid-60s, so they're actually contributing to their nest egg during that period when we would actually expect that they would be drawing down their assets.
>
> Currently there is also an incentive for people to reduce their assets to go on the pension—there are benefits available to a pensioner, such as healthcare concessions et cetera—yet we don't see people behaving in this way.[15]

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12 Australian Shareholders' Association, *Submission 119*, p. 4.

13 Plato Investment Management Ltd., *Submission 407*, p. 1.

14 Mr Russell Picton, *Transcript*, 30 January 2019, Alexandra Headland, p. 5.

15 Ms Danielle Wood, Program Director, Budget Policy and Institutional Reform, Grattan Institute, *Transcript*, 22 November 2019, Melbourne, p. 34.

Box 2: Claims those on modest incomes will be affected

‘We are not wealthy by Labor's definition of $2.4 million—nowhere near it. We've saved and worked hard to accumulate sufficient savings to replace the government pension with our own self-funded income stream. We don't want to be on the government pension.’
(Peter Black, *Transcript*, 30 November 2018, Dee Why, New South Wales, p. 9)

‘…we will see a reduction of approximately 20 to 26 per cent, depending on the year, in our cash flow. We may have to reduce the scale of our private health insurance at a time when we are more likely to actually need it.’ (Doug Cummings, *Transcript*, 20 November 2018, Sydney, p. 50)

‘If Labor Party policy is implemented, we will lose $18,150 per annum, or $349 per week. There is no prospect of covering this shortfall. This policy would fast-track us toward the old-age pension. Major expenses like our health insurance would have to be reconsidered.’ (Alistair Daley, *Transcript*, 20 November 2018, Sydney, p. 50)

‘This Labor policy will reduce our retirement income by around 25 per cent, or about $15,000 a year, based on our last tax return. This income will leave us marginally above the couples full age pension rate, but we will not receive the associated pension benefits. Our net position will be that we're worse off than couples on the full pension, including the value of associated benefits.’ (David Warner, *Transcript*, 30 January 2019, Paddington, Queensland, p. 4)

‘We are not wealthy and planned to retire on a modest income. These changes to the franking credit refunds are estimated to reduce our income by 22%. We are not wealthy, why are they attacking our lifestyle at this stage of our lives when we have no chance to recover the lost income?’ (Name withheld, *Submission 1057*, p.1)

‘My husband and I are a retired couple in our 70s, entirely reliant on our SMSF for income. We are not rich. We do not qualify for the age pension. And, yes, we will lose about 12.5 per cent of our income.’(Pauline Bartle, *Transcript*, 8 February 2019, Chatswood, New South Wales, p. 5)

‘It seems to me wrong that they're going to take that surplus imputation credit from us and give it back to us as welfare. We can't go back. We can't turn the clock back. We obeyed the rules of the day. We can't go back and start again.’ (Ray Trestrail, *Transcript*, 30 January 2019, Alexandra Headland, Queensland, p.7)

2.24 A number of people who claim they will be affected by the ALP's policy expressed concern that franking credits will still be included against assessable income for access to other public benefits including the Commonwealth Seniors Health Card. For example, Mr John Gates said 'I'm going to lose my card. What's the effect? When I lose my card, I lose my pharmaceutical benefits. So does my wife. We also lose our free access to X-rays, scans, MRIs etc.'[16]

Stress and complexity for older Australians

2.25 Much of the evidence provided to this inquiry details the concerns of Australians who claim they would be financially affected by the ALP's policy. While individual circumstances vary among those who made submissions or spoke at public hearings, two commonly expressed concerns were:

- increased stress arising from the threat of reduced income, and
- increased complexity arising from the need for some to alter their financial arrangements, particularly for older Australians.

2.26 A range of people claimed that they are on modest incomes, and are unlikely to be able to go back into the workforce to make up for the income they will lose as a result of the ALP's policy. For example, Mr Chris Young, a SMSF retiree, said:

> At our stage of life my wife and I have no ability to adjust our investment decisions to replace the projected loss of income. We cannot go back to work or sell out and buy overseas shares or property.[17]

2.27 Mr Michael Nordstrom said that he retired three months before the ALP's policy announcement, and has subsequently gone back to work:

> With Labor's announcement of its plan to deny the cash refund of franking credits, retirement savings plans my wife and I had made over decades based on stable government tax policy that had been in place with bipartisan support with Labor and Liberal governments for 18 years were shattered. I was so distressed that I found part-time casual employment to offset the financial impact.
>
> I am fortunate. Many people our age are trapped without opportunity or ability to work and are not eligible for the age pension until age 67; I am still six years away from that. Labor's

16 Mr John Gates, *Transcript*, 20 March 2019, Mount Martha, p. 5.

17 Mr Chris Young, *Transcript*, 4 February 2019, Merimbula, p. 4.

> pensioner guarantee is of no use to people like us, who are too young for the age pension. [18]

2.28 Generation Wealth Partners commented that many of his clients 'understand it will add to existing financial pressures and anxieties', noting some will see a loss of income of between 20 and 30 per annum.[19] Generation Wealth Partners said:

> This seems to be a rather cruel reduction of disposable income which will be suffered most by people who have retired and have no ability to work longer or appropriately adjust their financial affairs.[20]

2.29 Some of those affected claimed they would need to engage financial advisors as a result of the policy, and expressed their concern about this potential additional cost and complexity. Former stockbroker and retiree Mr Harold Shapiro said many of those affected are 'unsophisticated investors' and explained:

> Those individuals will have invested in solid, blue-chip-dividend-listed securities and will now face the stressful dilemma of either totally sacrificing their lost income or trying to replace it with alternative, high-yielding investments.[21]

2.30 Other individuals and stakeholders[22] claimed there would be a reduction in charitable donations as a consequence of the ALP's policy. For example, SMSF retiree Dr John Mayo said:

> The major thing is the impact this will have on charities' donation income…I think I could say, anecdotally, that the average retiree is pro rata going to be doing more to support charities, financially and in volunteer work, than the average person who is earning an income, paying off their house, paying their mortgage and bringing up their children.[23]

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18 Mr Michael Nordstrom, *Transcript*, 26 February 2019, Norwood, p. 16.

19 Mr Joe Jutrisa, Director/Financial Adviser, Generation Wealth Partners, *Transcript*, 20 November 2018, Sydney, p. 33.

20 Mr Joe Jutrisa, Director/Financial Adviser, Generation Wealth Partners, *Transcript*, 20 November 2018, Sydney, p. 33.

21 Mr Shapiro, *Transcript*, 8 February 2019, Bondi Junction, p. 7.

22 Law Council of Australia, *Submission 426*, p. 3.

23 Dr John Mayo, *Transcript*, 29 January 2019, Townsville, p. 2.

Box 3: Claims the ALP's policy is discriminatory

'To allow one citizen a tax credit and deny another citizen the same credit would be blatant discrimination. It is also discriminatory that a retiree with their superannuation in an industry fund will still receive the benefit from imputation credits.' (Keith Muller, *Transcript*, 30 January 2019, Alexandra Headland, p. 3)

'In regard to Labor's plan to introduce a retirement and pensioner tax, I believe it is discriminatory to tax people on the basis of who manages their super. It's also discriminatory to favour people on government pensions up to a certain date over those who qualify for a pension after that date.' (Kevin Farrell, *Transcript*, 30 January 2019, Alexandra Headland, p. 8)

'The proposal fails the essential integrity tests of equity and neutrality. It is this failure that is made worse by the exemptions given to unions and other not-for-profits and pensioners. If Labor has a problem with self-managed super funds it should go after them directly and leave the self-funded retirees alone and not make a shambles of the system of company tax profits.' (Steve Martin, *Transcript*, 30 November 2018, Dee Why, p.39)

'There are some issues in the proposal that I think are unfair. One that's very blatant is the fact that they intend to allow the part-pensioners to keep their franking credits. So in that instance there will be quite a few part-pensioners who will then be better off than fully funded retirees. We don't ask the government for anything, but we do want to be left alone. We want to be able to keep what we have earned and what is rightfully ours.'
(Patrice Butterworth, *Transcript*, 30 January 2019, Alexandra Headland, p.6)

'…the only way I can avoid this is actually to go and get a job and try to earn some money outside so I can get tax to get the offsets which other people are able to draw on. So I think this is a cruel and unfair grab for tax. Who can afford to hand out $18,000 out of their living expenses because the government needs money?' (Noel Wendt, *Transcript*, 30 January 2019, Paddington, Queensland, p.2)

'I never, ever expected, in this day and age when there is so much discussion about fairness, that a proposed government would change the rules once we'd started playing. Try doing that in a football match. It's just not right. We made these plans on the basis of what was law, what was legislated. To now pull the rug out from under us and a million other people who are not in a position to rebuild their finances, to go and get a job, is grossly unfair.'
(Margo Kalkman, *Transcript*, 31 January 2019, Eight Mile Plains, p.8)

Claims the policy undermines SMSFs

2.31 Many of those who made submissions or spoke at the public hearings argued that the ALP's policy is discriminatory because, they claim, it will unfairly affect retirees in SMSFs.

2.32 The committee also heard that, under the ALP policy, franking credits would not offset the total tax liability for superannuation accounts in the accumulation phase and that this effectively exempts industry funds and some retail funds. The Alliance said that, in doing so, the policy creates a two-tiered superannuation system, which is unfair and discriminatory.[24]

2.33 The Institute of Public Accountants argued the ALP's policy is 'grossly unfair' because it affects SMSFs but not APRA-regulated funds:

> [The policy] unfairly discriminates SMSFs and creates a distinction between SMSFs and large industry and retail funds, including the Future Fund. The policy change impacts SMSF differently to other segments and this creates an uneven playing field. Pooled funds will become a more attractive option for SMSF members as they will continue to make full use of all the credits they receive whereas SMSFs may not have enough tax liabilities to offset the full value of any imputation credits they receive.[25]

2.34 Similarly, CPA Australia claimed Labor's policy is 'highly iniquitous and punitive, creating a two-class system of "haves and have-nots".'[26] CPA Australia explained:

> The so-called "haves" are industry and retail super funds, and high-income earners who will be able to use their franking credits to offset other tax liabilities. The have-nots would be certain self-managed super funds (SMSFs) and low-income investors including pensioners.[27]

2.35 National Seniors Australia claimed the ALP's policy discriminates against self-funded retirees in favour of those drawing an Age Pension because it affects retirees on modest incomes differently depending on whether they were eligible for a part or full Age Pension before 28 March 2018 under the ALP's pensioner guarantee.[28]

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24 Professor Deborah Ralston, Chair, Alliance for a Fairer Retirement System, *Transcript*, 20 November 2018, Sydney, p. 17.

25 Institute of Public Accountants, *Submission 418*, p. 7.

26 CPA Australia, *Submission 424*, p. 1.

27 CPA Australia, *Submission 424*, p. 1.

28 Mr Graeme Bottrill, National President, Australian Investors Association, *Transcript*, 20 November 2018, Sydney, p. 22

Possible impact on share market

2.36 Some of those who gave evidence claimed that the ALP's proposal will reduce the value of Australian shares, reduce investment in Australian companies and lead to more Australians investing overseas.

2.37 For example, the Alliance argued that the current dividend imputation system incentivises investment in Australian companies and that the ALP's policy would drive down share prices, particularly for the Australian banks:

> By enabling capital formation in Australia, the current dividend imputation policy enhances investment in Australia, which in turn generates tax revenue (franking credits are not earnt on foreign income) and the prosperity gains are enjoyed by Australian shareholders. This will change as investors move away from investing in dividend-paying Australian companies. While the move into international equities is good for diversification in an investment portfolio, a recent Citigroup report suggests the policy if implemented will reduce local investor demand for high dividend-paying companies and may see a decline of 5-10% in the share price of the major banks.[29]

2.38 The Financial Services Council claimed that 'changes to franking refunds are likely to mean Australians invest more offshore. To replace the lost domestic investment, this will require an increase in foreign investment into Australia.'[30]

2.39 By contrast, Economist Mr Stephen Koukoulas argued that the current dividend imputation distorts 'the way we Australians invest our savings.'[31] He said:

> Many investors put money into companies that pay high, fully franked dividends regardless of the underlying strength or the potential of that business. Look at Telstra; look at the banks. It is uneducated and lazy investing recommended by lazy financial planners.
>
> …It is only the dividend, not the underlying strength of the business that guides much of the investment process. It is one reason why the Australian stock market is 15 per cent below the level of 2007, and this is while the US, German, Canadian and UK stock markets are substantially higher. None of these countries

29 The Alliance, *Submission 411*, p. 7.

30 Financial Services Council, *Submission 429*, p. 16.

31 Mr Stephen Koukoulas, *Transcript*, 8 February 2019, Bondi Junction, p. 10.

> have refundable franking credits. Investors in those countries provide finance to dynamic growth companies and strong businesses. In Australia, such companies are often shunned by investors because they pay no or low dividends. Investors instead place their money with what are average firms that structure their businesses according to the tax distortions.[32]

Support for the policy

2.40 A number of stakeholders and individuals gave evidence in favour of the ALP's proposal to remove refundable franking credits for all but those on income support. For example, the Grattan Institute, The Australia Institute, Industry Super Australia and the Australian Council of Social Service support the proposal because they believe it will mainly affect wealthy Australians, and that it is necessary to make the Budget sustainable.[33]

2.41 The Australia Institute argue that dividend imputation 'has never been well understood and there is only a small group of very wealthy Australians who would miss it.'[34] The Australia Institute estimate its abolition 'could save the government around $35 billion per annum by the end of the forward estimates (2020-21).'[35]

2.42 According to the Australia Institute, the wealthy are the main beneficiaries of franking credits. It stated that, of those people who lodged a tax return in 2014-15:

- 1.4 per cent of the population earned $250,000 or more but received 37.1 per cent of the total franking credits.
- 3.5 per cent earned $150,000 to $250,000 and received almost 17 per cent of the franking credits
- 0.08 per cent (11,128) people earned $1 million or more and received 65.7 per cent of the franking credits.[36]

2.43 The Grattan Institute use the analysis of the proposal by the Parliamentary Budget Office (PBO) to argue that the policy 'is a fair way

32 Mr Stephen Koukoulas, *Transcript*, 8 February 2019, Bondi Junction, p. 10.

33 Grattan Institute, *Submission 435*, pp. 3-8, pp. 10-11; The Australia Institute, *Submission 410*, p. 5; *Industry Super Australia*, Submission 414, p. 11. Australian Council of Social Service, *Submission 431*, p. 2.

34 The Australia Institute, *Submission 410*, p. 8

35 The Australia Institute, *Submission 410*, p. 8

36 The Australia Institute, *Submission 410*, p. 4

to help improve the budget and wind back the growing intergenerational transfers in our tax system.'[37] The Grattan Institute said the policy 'will make a substantial contribution to budget repair.'[38]

2.44 Similarly, Industry Super Australia drew on the PBO analysis to argue 'the vast majority of retirees will be unaffected by the proposal and the wealthy are the beneficiaries of most of the refunds of franking credit for non-pensioners.'[39]

2.45 Industry Super Australia said that the policy will 'add significantly to the sustainability of the revenue base', noting that annual cash imputation credits paid to non-pensioners with shareholdings are 'broadly equivalent to total annual expenditure on Veterans Affairs income support and disability payments.'[40]

2.46 The Australian Council of Social Service argued that those most affected by the proposal are mostly wealthy people who can afford to make a bigger contribution in tax:

> Those most adversely affected by the removal of refundable imputation credits would for the most part be relatively wealthy people with substantial income from self-managed superannuation funds, who pay little or no income tax due to a combination of the generous tax treatment of superannuation post-retirement and the Seniors and Pensioners Tax Offset. It would be misleading to describe this group as 'low income-earners', as their taxable incomes are a poor measure of their ability to pay. Most can well afford to contribute more to the future costs of health and aged care.[41]

2.47 SMSF retiree Mr Malcolm Faul noted the policy 'will cost me a significant amount of money, but I think it's the right thing to do'. Mr Faul explained:

> We've been subsidised throughout our working lives by contributions to super being lightly taxed. We're subsidising our retirement by having tax-free income, which was not always the case. We've had it pretty good. Maybe there are some adjustments

37 Grattan Institute, *Submission 435*, p. 1. The Grattan Institute favours more substantial reforms, which it argues 'would achieve the same benefits but without some of the investment-distorting effects of Labor's policy.'(p. 1) These reforms include 'taxing superannuation earnings in the pension phase at 15 per cent (super distributions would remain tax free) and winding back the Seniors and Pensioners Tax Offset.' (p. 1)

38 Grattan Institute, *Submission 435*, p. 2.

39 *Industry Super Australia*, Submission 414, p. 4.

40 *Industry Super Australia*, Submission 414, p. 11

41 Australian Council of Social Service, *Submission 431*, p. 2.

> needed—maybe some feed-in time is required—and I think industry funds should not be favoured over self-funded retirees. If that's part of the proposal, I'm against it.[42]

2.48 Another witness supported the ALP's proposal and took issue with the description by many participants of the policy as a retiree tax:

> It is not a tax. It is nothing like a tax. It is a removal of a tax rebate for people who pay no tax. This is not money that these people have earned. This money comes out of other taxpayers' pockets in such a large amount that it would cover the funding of public schools all across Australia.[43]

2.49 Mr Stephen Koukoulas argued that the policy would be positive for the economy and that the current dividend imputation system was harming investment in Australian technology and start-up companies:

> The Australian tax distortions mean that local entrepreneurial firms have to access their capital from overseas because the money here is tied up in dinosaur companies that pay high dividends. It's one reason why so many 21st century technology and start-up firms in Australia head overseas to pursue their business models—they cannot get capital in Australia. This costs the Australian economy growth and jobs.
>
> With the policy on refundable franking credits, there will be a greater incentive for people to invest in companies and other assets for reasons of growth and entrepreneurial flair, which will be beneficial to our economy and jobs and will be good for the long-term future of the Australian economy and, in the process, will start to reduce Australia's government debt.[44]

Options

2.50 While many opponents of the ALP's policy called for it to be rejected outright, several options were proposed to limit the policy's impact on those with low incomes or to allow people more time to rearrange their financial affairs. These options include capping refunds, grandfathering existing arrangements and delaying the start date of the ALP's policy.

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42 Mr Malcolm Faul, *Transcript*, 19 March 2019, Malvern, p. 15.

43 Name withheld, *Transcript*, 19 March 2019, Chatswood, p. 11.

44 Mr Stephen Koukoulas, *Transcript*, 8 February 2019, Bondi Junction, p. 10.

Box 4: Claims the policy has led to uncertainty for SMSF retirees

'We have a great deal of uncertainty about what the future holds for us, but it's particularly dangerous when it becomes apparent that there is now uncertainty about the past. I think that anybody who is proposing these sorts of things ought to consider that. It particularly applies to people who are in much less of a position to be able to adjust their future earnings because of their age, their infirmity and all those sorts of things.' (Michael Murphy, *Transcript*, 31 January 2019, Eight Mile Plains, p. 5)

'The federal opposition stated that they are giving us time to rearrange our investments to overcome this massive policy change. Given the current investment climate any change to recover our lost 15 per cent would involve potentially greater risk and therefore increased prospect of reduced income in future years.' (Campbell Edmondson, *Transcript*, 20 November 2018, Sydney, p. 49)

'This will lower our income by approximately 15 per cent per annum, which is over a thousand dollars a month in pay. Our only means of replacing this income is to run down our capital at a much faster rate and, at some stage in the future, become reliant on government handouts. So, at a stroke of the pen, our retirement plans, worked towards as payee taxpayers, are null and void.' (Rhonda Cadzow, *Transcript*, 31 January 2019, Upper Coomera, p. 7)

'We need to stop the continual changes. Super is the income stream of all retirees now and in the future. Future generations are becoming increasingly hesitant about tax and about super. Canberra needs to reward those who plan their future finance.' (Carolyn Baker, *Transcript*, 31 January 2019, Upper Coomera, p. 15)

'I retired five years ago believing we had been proactive in funding our own retirement. I now realise, stunned, that all we have planned and worked towards and thought we had achieved according to the rules of the day could be undone if the policy of scrapping the refund of excess credits is implemented. I cannot go back and start again.' (Cyril Gaudart, *Transcript*, 30 January 2019, Alexandra Headland, Queensland, p. 6)

'All I care about is that I have enough income in future years to cover my household and medical expenses. I have already downsized to reduce my living costs. My fridge is 30 years old. My car is 16 years old. I worry that if Labor's franking credit policy is introduced I won't have enough money to cover my medical costs. Without my two private prescriptions I would be in so much pain that I wouldn't be well enough to continue living independently in my home. Quite frankly, I fear for my future pension.' (Mary Starck, *Transcript*, 26 February 2019, Norwood, p. 25)

Reject the policy outright

2.51 Many of those claiming to be affected by the ALP's policy, like Mr Charles Duncan, called for the policy to be abandoned:

> It is wrong. It is unconscionable. It is unfair—it is grossly unfair. I really have to hope fervently that the parliament will have the courage to realise that this is a bad policy and to abandon it before it becomes law.[45]

2.52 Similarly, Wilson Asset Management said there should be no change to the current dividend imputation system and argued the ALP's policy would not result in the cost savings being claimed. Wilson Asset Management said 'the flow-on effects will damage the Australian economy and disproportionately burden low-income earners and retirees.'[46]

Cap refunds

2.53 A number of stakeholders and individuals called for the ALP to introduce a cap on the value of refunds. For example, the ASA opposed the policy, but said that limiting the refund 'to a minimum amount for people on lower incomes' should be canvassed. The ASA said such a cap 'would not come at a huge budgetary cost and could be phased out over time.'[47]

2.54 Similarly, the Association of Superannuation Funds of Australia said:

> …if there is a concern about individuals with large retirement savings receiving the benefit of refundable franking credits then imposing an appropriate cap on the benefits of refundable franking credits should be considered.[48]

2.55 Mr Peter Vincent, a SMSF retiree, called for the ALP to compromise on its policy and introduce a cap:

> I say to the Labor Party, there has to be some form of compromise…It's really easy, if you feel that the system is being blighted by the wealthy, even though what you've heard today probably dismisses a lot of that, then you can put a cap.[49]

45 Mr Charles Duncan, *Transcript*, 31 January 2019, Upper Coomera, p. 12

46 Mr Geoff Wilson AO, Chairman, Wilson Asset Management, *Transcript*, 30 November 2018, Dee Why, p. 2.

47 Australian Shareholders' Association, *Submission 119*, p. 11.

48 Association of Superannuation Funds of Australia, *Submission 427*, p. 2

49 Mr Peter Vincent, *Transcript*, 8 February 2019, Bondi Junction, p. 16.

2.56 SMSF retiree Mr Hicks called for the policy to be modified to include a cap of between $8,000 and $10,000 on a taxpayer's refundable franking credits and said 'by making this a fixed, non-indexed sum, its effect on the budget will be reduced over time by inflation.'[50]

2.57 The Australian Investors Association said that a cap could lessen the impact of the policy on those with low incomes:

> There have been suggestions of a cap on the refundability of franking credits and figures of $10,000 or $15,000 have been mentioned. If that were the outcome, that would improve things a little bit, but maybe not enough.[51]

Grandfather existing users

2.58 Other stakeholders and individuals who oppose the policy said that if it is introduced, any changes should be grandfathered. For example, the ASA called for the ALP to 'introduce grandfathering arrangements, so that those on modest incomes in retirement are not pushed onto the Age Pension.'[52]

2.59 SMSF retiree Mr Cyril Gaudart said 'there are alternative compromises, the first one being: don't have that policy. But, if you have to have it, grandfather it so people like us, who have had our time, paid our dues, are not penalised.'[53]

2.60 Similarly, SMSF retiree Mr Noel Wendt said:

> It's supposed to be affecting the wealthy and stopping rorting. Well, I'd suggest there are many retirees with very modest means who are being affected by this. Anyone already in retirement with their super fund, I believe, should be grandfathered so that they are allowed to draw the funds, because you shouldn't be messing with superannuation and retirement planning, which is a long-term process.[54]

Delay the start date

2.61 Several of those who claim they would be affected by the policy called for the ALP to delay the policy's start date. For example, SMSF retiree Mr Edward Ion said:

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50 Mr Ron Hicks, *Transcript*, 8 February 2018, Chatswood, p. 6.

51 Mr Graeme Bottrill, National President, Australian Investors Association, *Transcript*, 20 November 2018, Sydney, p. 24

52 Australian Shareholders' Association, *Submission 119*, p. 11.

53 Mr Cyril Gaudart, *Transcript*, 30 January 2019, Alexandra Headland, p. 6.

54 Mr Noel Wendt, *Transcript*, 30 January 2019, Paddington, p. 2.

> Changes to the retirement age pension access and asset limits were phased in over time to not disadvantage those already retired or approaching retirement and who had planned ahead for the event. Bringing in any changes to franking credit rebates would be must be similarly treated to avoid disadvantaging any group.[55]

2.62 Another SMSF retiree said 'it is totally unfair to make such a large change at the stroke of a pen' and called for the policy either to be grandfathered or 'phased in gradually over say three- to five-year period.'[56]

2.63 Similarly, SMSF retiree Mr Dan Steiner called for the policy to be grandfathered, a cap to be placed on refunds or for the changes to be phased in over a period of time. Mr Steiner noted that 'tax cuts are phased in over a period of time' and argued that 'this is, from my perspective, certainly a tax.'[57]

Conclusion

2.64 The committee has considered the case for removing refundable franking credits for individuals and SMSFs and is of the view the policy is inequitable, deeply flawed and the timeline is rushed.

2.65 In particular, the ALP's policy will unfairly hit people of modest incomes who have already retired, and who are unlikely to be able to return to the workforce to make up for the income they will lose.

2.66 In doing so, the ALP's policy will force many people, who have saved throughout their lives to be independent in retirement, onto the Age Pension. This defeats the stated purpose of the policy, which is to raise revenue.

2.67 The ALP has said that its policy to scrap refundable franking credits is designed to tax the wealthy. This is an unfair and untrue characterisation of the 900, 000 Australians who will be affected by the ALP's policy, and the distributional data relied upon to assess the distribution of refundable franking credits does not factor in the introduction of the transfer balance cap.

2.68 The Alliance for a Fairer Retirement System claims that, in 2014-15, over half of those receiving cash refunds for their franking credits had incomes below the $18,201 tax-free threshold of the time, and 96 per cent

55 Mr Edward Ion, *Transcript*, 25 February 2019, Guildford, p. 6.

56 Name withheld, *Transcript*, 30 January 2019, Paddington, p. 7.

57 Mr Dan Steiner, *Transcript*, 26 March 2019, Canberra, p. 3.

had taxable incomes of less than $87,000.[58] These people are hardly wealthy, yet they stand to lose up to 30 per cent of their income under the ALP's plan.

2.69 Furthermore, as Treasurer Frydenberg has noted, if the ALP's policy went ahead, a person with a high taxable income of $200,000 a year and who is receiving a $7000 dividend on their shares would still receive all of their $3000 franking credits.[59]

2.70 However, a retiree with a SMSF in pension phase will not be refunded their franking credits. A person with a low income under the tax-free threshold, for example a grandchild who has inherited some shares, will also lose their franking credits.

2.71 The policy discriminates against retirees in SMSFs, in favour of members of APRA-regulated industry and retail superannuation funds, and those eligible to receive a part or full Aged Pension before 28 March 2018.

2.72 The policy may also reduce the value of some Australian shares and reduce investment in Australian companies.

2.73 A range of submitters were concerned about the need to rearrange their investments, and to reduce spending, particularly on private health insurance and charitable donations as a consequence of the ALP's policy.

2.74 The committee is concerned that these serious policy implications have not been addressed by the ALP.

2.75 In consideration of the evidence received during this inquiry, the committee does not support any change to the refundability of franking credits and calls on the ALP to abandon its unfair policy.

Recommendation 1

2.76 **The committee recommends against the removal of refundable franking credits.**

58 Alliance for a Fairer Retirement System, *Submission 411*, Attachment A - 'Alliance Fact Sheet', p. 1.

59 The Treasurer, The Hon Josh Frydenberg MP, 'Labor's Retirees Tax Hits Hard Working Australians', *Media Release*, 21 January 2019.

Recommendation 2

2.77 **The committee recommends any policy that could reduce Australian retirees' income by up to a third should only be considered as part of an equitable package for wholesale tax reform.**

Tim Wilson MP
Chair
1 April 2019