## House of Representatives
## Standing Committee on Economics

# Inquiry into the implications of removing refundable franking credits

Submission by

**The Australian Investors Association Limited**

Unit 3, 54 Siganto Drive
Helensvale QLD 4212

PO Box 1208
Oxenford QLD 4210

Phone: 1300 555 061
Email: aia@investors.asn.au

Prepared by Jon Kalkman and Graeme Bottrill

Dated: - 29th October 2018

## Table of Contents


| | | |
|---|---|---|
| | **Terms of Reference** | Page 2 |
| | **Executive Summary** | Page 3 |
| 1. | **How refundable franking credits support tax principles,** particularly implications for tax neutrality, removal of double taxation and fairness | Page 6 |
| 2. | **Analysis of who receives refundable franking credits,** the opportunities it provides to offer alternative savings and investment vehicles to low and middle income earners, and the impact it has on lowering tax bills | Page 8 |
| 3. | **Who would be impacted If refundable franking credits are removed**; and how and the implications from expected behavioural change by investors | Page 17 |
| 4. | **If there are carve outs applied,** what this might mean for additional complexity, uncertainty and fairness | Page 19 |
| 5. | **Reduced incentives to save** and distortions to which asset classes are invested in and funds are used - stress and complexity it will cause for Australians, including older Australians to adjust their investments | Page 24 |
| 6. | **The reliability of providing a sustainable revenue base over the longer term.** | Page 28 |
| 7. | **Conclusion** | Page 31 |
| 8. | **Recommendation** | Page 31 |
| 9. | **Impact on members of the Australian Investors Association** | Page 32 |
| 10. | **Appendices:** | |
| | Appendix A - Case studies | Page 34 |
| | Appendix B – The myth about Costello's super generosity | Page 37 |
| | Appendix C – Income calculations | Page 40 |


The **Terms of Reference** for the inquiry are for the committee to inquire into and report on the use of refundable franking credits, their benefits and the implications of their removal, including:

• analysis of who receives refundable franking credits, the opportunities it provides to offer alternative savings and investment vehicles to low and middle income earners, and the impact it has on lowering tax bills

• consideration of how refundable franking credits support tax principles, particularly implications for tax neutrality, removal of double taxation and fairness

• if refundable franking credits are removed; who it would impact and how and the implications from expected behavioural change by investors, including for - increased dependence on the pension

- stress and complexity it will cause for Australians, including older Australians to adjust their investments
- if there are carve outs applied, what this might mean for additional complexity, uncertainty and fairness
- reduced incentives to save and distortions to which asset classes are invested in and funds are used, and
- the reliability of providing a sustainable revenue base over the longer term.

## Executive Summary

**1. Consideration of how refundable franking credits support tax principles, particularly implications for tax neutrality, removal of double taxation and fairness**

Franking credits transfer all of a company's profits to shareholders as additional income so that Australian shareholders only ever pay tax on their dividends at their marginal tax rate and foreign investors always pay tax on their Australian dividends at the company tax rate.

We discuss:

- History of Imputation/franking
- Only Australian shareholders benefit
- Labor's Announcement

**2. Analysis of who receives refundable franking credits, the opportunities it provides to offer alternative savings and investment vehicles to low and middle income earners, and the impact it has on lowering tax bills**

This proposal will mean that any taxpayer whose franking credits exceed their tax liability will no longer be able to claim a cash refund for the excess tax already paid, unless the taxpayer belongs to an exempt group.

Labor's proposal focuses only on the tax credit, while wilfully ignoring the fact that shareholders also have a higher taxable income (and tax liability) due to those dividends. Therefore, Labor deceitfully asserts that franking credits are a gift from the ATO through a loophole unavailable to less sophisticated investors.

**The proposal affects all taxpayers who generate franking credits that are greater than their tax liability, unless they receive a Centrelink pension or allowance.**

The investment in franked Australian equities is the backbone of many retirement incomes and incomes of those with small investments and low additional incomes. It particularly affects members of self-managed super funds where no member was a Centrelink pension recipient prior to the 28th March 2018. Therefore, all self-funded retirees who are not eligible for the age pension will be enormously disadvantaged, depending on their exposure to Australian shares.

We discuss:

- Company tax is constant – income tax is progressive.
  Taxpayers with the lowest income tax rate are hardest hit
- Low-income spouse / part-time worker
- Self-funded retiree without super
- Superannuation funds
- Workers in accumulation mode
- Self-funded retirees in pension mode

**3. If refundable franking credits are removed; whom it would impact and how and the implications from expected behavioural change by investors**

We discuss:

- Changing the asset allocation
- Move to an Industry fund
- Make more use of accumulation funds

**4. If there are carve outs applied, what this might mean for additional complexity, uncertainty and fairness**

The proposal to withhold the refund of excess franking credits from random groups has inflamed huge numbers of investors, retirees and those preparing for retirement, and thrown their retirement plans into chaos.

The exemption for age pensioners creates a very sharp demarcation between those who will receive refundable franking credits and those who won't. A couple owning their own home will need $1.2 million to generate the same income (without refundable franking credits) as a couple with half those assets but eligible for both the age pension and refundable franking credits.

Once assets exceed the upper limit for the part-age pension and eligibility for the age pension ceases, income falls by up to 30% due to the total loss of all franking credits. That will create enormous incentives for self-funded retirees to arrange their affairs in order to qualify for the age pension.

The Morrison changes to the age pension taper rate in 2017 have also meant that there is no additional income derived from having more than $374,500 invested, as for every additional dollar earned, a dollar of pension is lost.

We discuss:

- The incentive to qualify for the age pension
- The incentive to close your SMSF and invest in your own name

**5. Reduced incentives to save and distortions to which asset classes are invested in and funds are used - stress and complexity it will cause for Australians, including older Australians to adjust their investments**

This proposal has implicit incentives to adopt certain behaviours and profound long-term effects.

- Self-funded retirees will run out of money and apply for the age pension sooner.
- Non-pensioners will apply for the age pension.
- Existing pensioners will claim higher pension payments.
- Young people will give up on super.

We discuss:

- The proposal discourages investment in Australian shares
- Encourages a move super to Industry Funds
- Reduces Living Standards for self-funded retirees
- Encourage greater reliance on the age pension
- Creates a loss of confidence in retirement planning

**6. The reliability of providing a sustainable revenue base over the longer term.**

We discuss:

- Number of shares and the value of franking unchanged
- Labor's figures are misleading
- Much of the tax from super pensions is already being collected
- Potential source of revenue

## 1. Consideration of how refundable franking credits support tax principles, particularly implications for tax neutrality, removal of double taxation and fairness

**Discussion Points:**

- History of Imputation
- Only Australian shareholders benefit
- Labor's Announcement

Australian companies are required by law to pay tax on the profits generated in Australia at the prevailing company tax rate. Companies and their profits are owned by shareholders. The system of imputation requires the shareholder to include their share of **all** of the company profit, as determined by their shareholding, as part of their own taxable income. But the dividend they receive is paid out of the after-tax portion of the company's profit as the company tax has already been paid to the tax office. Therefore, in order to account for this company tax, the dividend has to be "grossed up" to include this tax already sent to the tax office.

For example, if the company profit was $100, the company would need to send $30 to the ATO (company tax rate is 30%[1]) and send $70 to the shareholder. Because *the shareholder is responsible for the tax on all the profits and not just the dividend*, their taxable income is $70 received as dividend PLUS the $30 company tax, withheld by the ATO. Their taxable income is $100, but the money already paid to the tax office is a tax credit when the shareholder completes their own tax return.

In this way, **all** *of the shareholders' share of the company's profits is transferred to the shareholder as additional taxable income***,** where it is then subject to the shareholder's marginal tax rate. As tax on this income is pre-paid tax, it is then a tax credit when the shareholder completes their tax return. **An imputation credit is both additional income and a tax credit**. Without a tax credit, the taxpayer would be paying tax on additional income withheld by the ATO, but never received. It is often referred to as a franking credit because it is **pre-paid tax**.

Because the dividend represents the 70% (after-tax) portion of the profit, to calculate the grossed-up amount, the dividend is divided by 7 and multiplied by 10. The tax credit is the difference between the "grossed-up" amount and the dividend. Alternatively, the dividend can be multiplied by 0.4286 (or 30 divided by 70). A refund for excess tax is not a special concession for shareholders, because they are required to pay tax on their share of **all** of the company's profits. A cash refund is only payable if there is an excess tax credit above the tax liability on that additional 42.86% income withheld by the tax office. That is the key; the amount of cash refund depends entirely on the taxpayer's tax liability.

[1] 30% is the company tax rate for companies with turnover greater than $50 million

## History of Imputation

Before the changes introduced by Treasurer Keating in 1987, shareholders also paid personal tax on after-tax profits distributed as dividends. This was double taxation. After 1987, franking credits could be used to pay a tax liability, but if the tax credits exceeded the tax liability, they were simply forfeited. The Howard Government changed this arrangement in 2001 so that, just as for a PAYG taxpayer, if the pre-paid tax exceeds the personal tax liability, the taxpayer is entitled to a cash refund of the excess, and if the pre-paid tax is insufficient, they need to pay the difference.

## Only Australian Shareholders benefit

This system ensures that Australian shareholders always pay tax on their dividends at their marginal tax rate. It also ensures that foreign investors, who do not have access to franking credits, always pay the company tax rate on their Australian dividends. If the company tax rate was zero, Australian shareholders would still pay tax on their dividends at their marginal rate, but foreign investors would pay no tax in Australia.

This is the genius of the imputation system: Australian shareholders only ever pay tax on their dividends at their marginal tax rate, and foreign investors always pay tax on their Australian dividends at the company tax rate.

It is important to stress the refund of franking credits does not mean any additional burden on the taxpayer because this tax has already been paid. If the franking credit refunds are removed, that will be a return to double taxation.

## Announcement

On 13 March 2018 the Opposition Leader (Bill Shorten) and Shadow Treasurer (Chris Bowen) announced that (if elected) from 1 July 2019, a Labor Government would implement a change to remove cash refunds for excess franking credits.

On 28 March 2018 the Opposition announced the so- called “pensioner guarantee”, that Centrelink age pensioners, non-aged pensioners on other allowances (such as carers, disability support pensioners, the unemployed and those on parenting payments), unions, charities, churches, universities and the Future Fund would be exempt from the policy previously announced. Self-managed superannuation funds with at least one pensioner or allowance recipient **before 28 March 2018** will also be exempt from the changes. These are the exempt groups.

## 2. Who receives refundable franking credits?

**Discussion Points:**

- Company tax is constant – income tax is progressive.
  Taxpayers with the lowest income tax rate are hardest hit
- Low-income spouse / part-time worker
- Self-funded retiree without super
- Superannuation funds
- Workers in accumulation mode
- Self-funded retirees in pension mode

The only asset class where the income arrives in the hands of the owner with tax already paid is Australian shares. Labor's proposal does not abolish franking credits, it merely withholds the pre-paid tax credit that is excess to a taxpayer's tax liability. All taxpayers who own some shares and also have low tax liabilities are affected. This proposal will mean that any taxpayer whose franking credits exceed their tax liability will no longer be able to claim a cash refund for the excess tax already paid, unless the taxpayer belongs to an exempt group[2].

### 1. Taxpayers with the lowest income tax rate are hardest hit

The company tax rate of 30% is constant, but income taxes are progressive. This generates excess franking credits (and therefore tax refunds) on **all** low and middle incomes.

Company tax is a constant 30% regardless of the amount of profit being taxed. When that company profit is transferred to the shareholder, it is **both additional income and a tax credit to account for the company tax already paid.** It therefore represents 30% of the total income that a taxpayer derives from Australian shares. If the franking credit exceeds the personal tax liability, the excess is presently refunded.

Australia's income tax is progressive. According to the ATO, the following are the current income tax scales:

| ***Taxable Income*** | ***Tax on this income*** |
|---|---|
| 0 - $18,200 | Nil |
| $18,201 - $37,000 | 19c for $1 over $18,200 |
| $37,001 – $90,000 | $3,572 plus 32.5c for each $1 over $37,000 |
| $90,001 – $180,000 | $20,797 plus 37c for each $1 over $90,000 |
| $180,000 and over | $54,097 plus 45c for each $1 over $180,000 |

As income rises, not only do taxpayers pay more tax, but they pay an increasing proportion of their income in tax. For example, from the above table the tax on an income of $37,000 is $3572. The marginal tax rate on each additional dollar is 19%, but as a proportion of the total, the tax is only 9.65%. This is the average tax rate. The tax on $90,000 is $20,797. The marginal tax rate on each additional dollar is 32.5%, but as a proportion of the total, the tax is 22.1%. A taxpayer earning $90,000 pays proportionally more tax than someone earning $37,000.

---

[2] The 'exempt group is defined on page 7

If we were to revert to the situation that existed before 1987 when there were no franking credits, there would be no additional taxable income and there would be no tax refund. Tax on dividends would be identical to the tax on bank interest.

***Table 1***

| ***Taxpayer >*** | ***A*** | ***B*** | ***C*** | ***D*** | ***E*** |
|---|---|---|---|---|---|
| Dividend | 21,000 | 35,000 | 49,000 | 70,000 | 140,000 |
| Tax payable | 532 | 3,192 | 7,472 | 14,297 | 39,297 |
| After Tax Income | 20,468 | 31,808 | 41,528 | 55,703 | 100,703 |
| Average tax rate | 2.53% | 9.12% | 15.25% | 20.42% | 28.07% |

If we fast-forward to today and assume that all of our example taxpayer's income is derived from franked dividends, the following table illustrates how the constant rate of company tax interacts with the rising proportion of tax as incomes rise. For simplicity, the tax payable has ignored the Medicare levy, which increases the tax and tax offsets which reduce it.

***Table 2***

| ***Taxpayer >*** | ***A*** | ***B*** | ***C*** | ***D*** | ***E*** |
|---|---|---|---|---|---|
| Dividend | 21,000 | 35,000 | 49,000 | 70,000 | 140,000 |
| Franking Credit | 9,000 | 15,000 | 21,000 | 30,000 | 60,000 |
| Taxable Income | 30,000 | 50,000 | 70,000 | 100,000 | 200,000 |
| Tax payable | 2,242 | 7,797 | 14,297 | 24,497 | 63,097 |
| Tax credit | 9,000 | 15,000 | 21,000 | 30,000 | 60,000 |
| Refund | 6,758 | 7,203 | 6,703 | 5,503 | -3,097 |
| After Tax Income | 27,758 | 42,203 | 55,703 | 75,503 | 136,903 |
| Average tax rate | 7.47% | 15.59% | 20.42% | 24.50% | 31.55% |
| LABOR PROPOSAL | | | | | |
| After Tax Income | 21,000 | 35,000 | 49,000 | 70,000 | 136,903 |
| Proposal effect | -32.18% | -20.58% | -13.68% | -7.86% | 0% |

In the table above, it is very clear that the franking credit is a constant 30% of the taxable income. It also shows that franking credit exceeds the tax liability on all incomes where the 30% company tax rate exceeds the average income tax rate. Under present rules, if the franking credit exceeds the tax liability, the excess is refunded as cash.

If the franking credit is additional income for one taxpayer it must be additional income for all taxpayers. If it is not additional income, we would be using Table 1 and everyone would be much worse off, precisely because it would be a return to double taxation.

It is very clear that if the franking credit is additional income, Taxpayer "A" has a taxable income of $30,000 and pays $2,242 in tax, with the tax credit of $9,000, s/he is entitled to a refund of $6,758. Under Labor's proposal, that excess tax credit will be withheld. Without the refund of the excess tax credit, Taxpayer "A" has a taxable income of $30,000 and an after-tax income of $21,000. S/he has paid $9,000 tax on that income compared to a PAYG taxpayer who pays $2,242 on the same taxable income.

Without the cash refund, many low and middle taxpayers' after-tax incomes are reduced. For low incomes that reduction is proportionally very large because the gap between their average tax rate and the constant company rate is also large. For higher incomes the reduction in after-tax income from this proposal becomes proportionally smaller because the difference between the constant franking credit rate and the average tax rate also becomes smaller.

That difference between the two rates disappears completely when the average income tax rate is equal to 30%. But the average tax rate does not reach 30% until incomes are very high. The above table clearly shows that only taxpayer "E", with the highest income, will not experience any reduction in after-tax income as a result of Labor's proposal and will continue to be able to fully utilise all those franking credits to pay their tax liability.

All taxpayers with dividend incomes lower than $140,000 will lose some of that credit refund, and those on the lowest incomes lose the most proportionally. This proposal has the effect of hitting taxpayers on the lowest tax rates the hardest, unless they belong to one of the exempt groups.

## 2. Low income spouse / part-time worker

This includes a low-income spouse. For example, consider a family comprised of two parents where one parent stays at home to look after the children and does not work in paid employment. The couple has been saving hard and has accumulated $200,000 in savings (equivalent to the required 20% deposit on a medium-priced house in Sydney).

The funds are invested in the stay-at-home parent's name in fully franked shares paying a 5% dividend. This equates to dividend income of $10,000 pa and franking credits of $4,285 pa. Under current tax legislation, the stay-at-home parent's taxable income is $14,285 ($10,000 + $4,285). No income tax is payable on $14,285 of annual income and so the stay-at-home parent gets a tax refund (the franking credits) of $4,285. Under Labor's proposal this person's taxable income is $14,285 and the after-tax amount is $10,000 because the franking credits will not be refunded, and yet this taxpayer is required to pay no tax because their taxable income is under the tax-free threshold.

The proposal has particular relevance to families in receipt of the Family Tax Benefit. Franking credits are added into the taxable income which will affect the Family Tax Benefits, but under this proposal any excess will not be refunded. Families could lose both their family tax benefits and their cash refund from franking credits. If cash refunds of excess tax paid are going to be limited by decree, then all PAYG taxpayers should be warned!

Also included are many part-time workers. For example, if a retiree had accumulated a parcel of shares paying franked dividends and went back to work part-time, s/he would find that, even though the franking credits increase their taxable income, if their tax liability is insufficient to soak up all the franking credits of their portfolio, their excess franking credits, presently refunded as cash, will also be seized.

## 3. Self-funded retirees without super

All persons of pension age or older are entitled to claim the Seniors and Pension's Tax Offset (SAPTO) against their tax liability. This tax offset effectively sets a new tax-free threshold so that a single senior can earn $32,279 and a couple can earn $57,948 before they pay tax. If that income includes any franked dividends, they presently generate a cash refund of the excess franking credits because the pre-paid tax is excess to their zero-tax rate. If these retirees do not receive any age pension, they will not be exempt from the policy and they will lose that cash refund.

There are many older self-funded retirees who saved for their retirement before super became available or popular. Many of them have used the franked dividends from Australian shares to replace or supplement their age pension. Because their assets are outside super, they will have a taxable income, but insufficient tax liability to absorb all their franking credits. They have come to depend on these cash refunds to maintain their living standards. They are already penalised by being too old to have super. The loss of this cash refund will be deeply felt, and changing investment strategy at their age will be very stressful and difficult.

**We provide this real Case Study as an example:**

*I would like to illustrate the case of people like myself and my wife who do not have any money in a SMSF but all investments are in our own names. We are in our mid 80's and SMSF's were not very well known or popular in 1995 when I received my super payout. At present one of our incomes is:*

| | |
|---|---:|
| *Dividend Income* | *$32,134* |
| *Franking Credits* | *$8,945* |
| ***Taxable Income*** | ***$41,079*** |
| *Tax on Taxable Income (incl. Medicare Levy)* | *$5,719* |
| ***Tax Credits:*** | |
| *Franking Credit* | *$8,945* |
| *Tax offsets* | *$163* |
| *Total Tax Credits* | *$9,108* |
| ***Tax Refund (Tax credits – Tax payable)*** | ***$3,389*** |

*The problem is that all the franking credits are added to my taxable income but, under this proposal, it does not get fully refunded as excess tax. To my knowledge, Labor has made no announcement about not including the non-refundable imputation credits in taxable income. Therefore, the excess tax credit $3,389 will be taxed at 34.5% plus the 30% paid by the company. Paul Keating said his policy was introduced to wipe out the double taxation of dividends so on this example dividends will be taxed at 64.5%. If Labor brings this in, then, as self-funded retirees, we will lose over $12,000 per annum, or about one-sixth of our annual income.*

*I have suggested to my wife that we go on a northern hemisphere cruise of long duration and fly both ways first class so as to qualify for both the age pension and refund of our excess franking credits.*

Under Labor's proposal, this refund will be withheld. The effect is that, whereas another taxpayer with a taxable income of $41,079 would pay $5,719 tax, with an after-tax income of $35,360. Without the cash refund, the taxpayer in the example above will be paying additional tax **on the same taxable income** and has an after-tax income of $32,297.

The ignorance around the fact that taxes on company profits are *both additional taxable income and a tax credit for shareholders*, allows Labor to pretend that company profits are somehow separated from the shareholders who are responsible for the tax payable on that profit. Labor's proposal focuses only on the tax credit, which may or may not be refunded, while wilfully ignoring the fact that shareholders also have a higher taxable income (and tax liability) due to those dividends. To complete the fiction, Labor likes to pretend that franking credits are a gift from the ATO through a loophole unavailable to less sophisticated investors.

In all of the above cases, the franking credit is added to the taxable income, but any excess franking credit will not be refunded. As the non-refundable franking credits are included in the taxable income, these taxpayers will be paying tax on income they never receive. Mr Shorten has said that if people do not pay tax, they should not get a refund, but there are many cases where taxpayers **do** pay tax and will still not get a refund. Perhaps the full implications of Labor's proposal are not well understood, but it isn't a question of how much tax you pay – it is the difference between the tax already paid and your own tax liability. Under Labor, for all Australian shareholders, the effective minimum tax rate on dividends (and only dividends) will be 30% **regardless** of their marginal tax rate.

To avoid distortions to the tax system, the tax on company profits (franking credits) must be part of the shareholder's taxable income, and the excess tax credit must be refunded if the shareholder is going to pay tax on that additional income at no more than their marginal tax rate.

## 4. Superannuation funds

Superannuation funds are single taxpayers on behalf of all their members. The government has recently legislated the purpose of superannuation. The legislated purpose is to supplement or replace the age pension. In order to encourage people to become less reliant on the age pension, superannuation has a range of tax concessions on contributions, on investment earnings and on retirement benefits. These tax concessions apply to both the funds holding these savings and the members of those funds. In any discussion about tax, it is also important to distinguish between the tax paid by the fund and the tax paid by the member when money is withdrawn from the fund.

The whole superannuation system, with its concessional tax rates, is exposed to this policy. In announcing this proposal, Labor drew attention to the benefits that all super funds gain from franking credits. Chris Bowen on 13 March 2018 said

> *Self-managed super funds are a major beneficiary of this practice, with 50 per cent of the benefit to SMSFs accruing to the top 10 per cent of SMSF balances – with some funds receiving cash refunds of more than $2.5 million a year.*

Unfortunately, the tax rules around super are complex and change regularly. After 30 years the operation of franking credits is very poorly understood. Therefore, it is important that we unravel the interaction between superannuation and Labor's franking credit proposal.

There are two phases of super and two different tax treatments. In accumulation mode people accumulate savings, in retirement mode those savings are used to replace or supplement the age pension.

**Three types of super funds**

There are also three types of super funds:

1. Industry funds are not-for-profit and have a board of trustees with equal representation from the industry and the unions, reflecting the input of management and workers, and managing the savings of thousands of members.

2. Retail funds seek to provide a profit for the large financial organisations such as the banks and AMP that own them, and;

3. Self-Managed Super funds (SMSFs) are funds where the members themselves become trustees with full responsibility for compliance and investment decisions.

The legislation governing super funds applies equally to all types of funds. When considering tax, it is important to note that a super fund is a single taxpayer and pays tax on behalf of all its members.

In accumulation mode before retirement, the fund accepts contributions and invests the money in a range of assets in preparation for retirement. No withdrawals are allowed until retirement or until a condition of release has been met. The nest egg accumulated for retirement is a function of the level of contributions, investment performance, the length of time the investments are held, minus fees and taxes. The accumulation period can be as long as 40 years.

Concessional contributions are those where no tax is paid by the member before the money is contributed to the fund. These include employer contributions, salary sacrifice and contributions where members have claimed a tax-deduction. Non-concessional contributions are made from after-tax money. These include an inheritance, the proceeds of the sale of an investment or general savings. The accumulation fund pays 15% tax on concessional contributions and 15% on income earned by the fund as well as 10% tax on capital gains on assets held by the fund for more than 12 months. No tax is paid by the fund on non-concessional contributions because this money has already been taxed.

In retirement mode, the fund supporting a pension pays zero tax on income or capital gains earned by a super fund. This has been the case since 1992 when super became universal and compulsory and has remained in place through the Costello super changes in 2007, the period when Mr Shorten was Minister for Superannuation in 2010, and the Morrison super changes in 2017. It reflects the fact that the money inside a pension fund has already been taxed, both as contributions and on the earnings over a long period of time. It is now a social contract and is seen as compensation for compelling people to lock away their super savings for up to 40 years.

A pension fund pays zero tax on its earnings. The fund cannot accept any more contributions **and** members are required by law to draw a mandated minimum each year that progressively increases with age. It increases from 4% of the fund balance at age 55 rising to 14% of the fund balance at age 95. That is the trade-off required in order to benefit from the zero-tax rate in pension mode, of which few working people are aware. The purpose and effect of these mandated pensions is to force retirees to progressively liquidate assets to pay these pensions, thereby removing money from the concessional area of super and preventing these concessional assets from being bequeathed to the estate. The fund is designed to be depleted. With our increased longevity, it also means that many retirees will outlive their super savings and fall back on the age pension. Importantly, there is no set maximum on withdrawals. Any lump sum withdrawals increase the rate of depletion.

By contrast, there is no obligation to withdraw any money from an accumulation fund in retirement. It can also accept contributions even if the member is not working up to age 65, and up to age 75 if they satisfy the work test. Super savings can remain in that concessional tax environment until death, and the fund continues to pay only 15% tax on its income. At death, the remaining super balance must be cashed out. There is a death tax of 15% (plus Medicare levy) on the remaining super balance, but it only applies to the concessional component. Large super balances typically have very small or zero concessional components. Further information on the death tax is available in Appendix B.

This continued tax concession for money in an accumulation fund that clearly is not needed for retirement purposes, is inconsistent with the government's legislated purpose for super and its commitment to preventing super from being used as an estate planning tool.

The rules around super have been subject to regular revision, thereby adding to the complexity and confusion. Before 2007, there were limits on concessional contributions, but these were more generous for older members. Significantly, there was no limit on non-concessional (after-tax) contributions. That explains why, until recently, there were SMSFs with very large super balances with many millions of dollars. There was also a Reasonable Benefits Limit that applied to people taking lump sums in retirement, but it only applied to the concessional component

Treasurer Costello introduced significant changes to tax on super. All withdrawals from super, pensions and lump sums, are now tax-exempt after the age of 60. There are many commentators who believe that that decision has made super unsustainable in the long term. In reality, very little revenue was collected from super in the retirement mode at that time, because the retirement benefit tax only applied to the concessional component and that tax was offset by a 15% rebate to compensate for the 15% tax on contributions and earnings.

Costello forfeited very little revenue, but the decision was politically very popular. It is important to note that no government since 2007 has contemplated reversing that decision, simply because it would be politically very unpopular and would still collect very little revenue. Appendix B explains that analysis more fully.

The other major change was that **for the first time**, there were limits placed on non-concessional contributions. In response to the outcry, the limit was set at $1million in the first year and reduced to $150,000 per year after that with the provision of bringing forward 3 years of contributions in one go. With indexation, that limit subsequently rose to $180,000 or $540,000 over 3 years.

The changes introduced by Treasurer Morrison from 1 July 2017 were more far-reaching. From that date, a member of a super fund cannot hold more than $1.6million in the tax-free area of a super pension fund. They are required to transfer their excess funds, either to an accumulation fund where the earnings are taxed at 15% or out of super altogether, where these investments will face normal tax. Significantly, any member of a super fund that already has $1.6million in total (accumulation and pension) is not allowed to make any more non-concessional contributions.

By definition, members with large super balances only achieved that by making large amounts of non-concessional contributions. Until 2017, the income from those investments in a pension fund had been tax-free. **For the first time**, the income that flows from the investment of non-concessional

contributions, now held in accumulation mode will be taxed, albeit still at a concessional rate. That income was never taxed before or after 2007. It is that tax liability that has significance in the context of Labor's franking credit refund proposal.

## 5. Workers in accumulation mode

An SMSF in accumulation mode, has a tax rate of 15%, but franking credits represent the 30% company tax pre-paid on the distribution of the dividend. If the fund has a high allocation to shares, because the members are young and are looking for the long-term growth of their fund, for example, it is possible that the fund will generate franking credits that are excess to the fund's tax liability. At present the refund of those excess credits as cash simply adds to the income of the fund, thereby allowing it to grow faster. Under this proposal, that cash refund will also be lost.

## 6. Self-funded retirees in pension mode

Probably the biggest group affected is self-funded retirees who use an SMSF to provide their income in retirement. This is the group who have assets higher than the age pension cut-off so they are not exempt, and they have assets below $1.6million so their fund has a zero-tax liability. Assets above $1.6m will generate tax liabilities that can use franking credits.

Income earned by a super fund in pension mode, is zero taxed. Obviously, any government could change the zero-tax rate for super funds in pension mode at any time. In the 26 years of operation, no government of either complexion has contemplated doing that, but doing so would raise the tax burden on retail, industry and self-managed super funds alike.

An SMSF solely in pension mode with less than $1.6million pays zero tax on the income and capital gains from ***all*** its assets. Therefore, ***any*** fully franked shares it owns will generate franking credits that are in excess of the zero-tax liability. If the SMSF loses the refund of franking credits it will be paying 30% tax on its dividends and zero tax on all other income.

The question of additional taxable income from franking credits does not arise because, with a zero-tax rate, the tax will be zero regardless of the size of the taxable income. In an SMSF in pension phase, the taxable income is only limited by the size of the fund. That is where the new restrictions on funds in pension phase being limited to $1.6million is crucial.

To the extent an SMSF is invested in Australian shares, the dividends represent 70% of the total income and the franking credit cash refund represents another 30%. The potential impact of this policy is a loss of income to an SMSF of up to 30%, depending on the fund's asset allocation to Australian shares. As all withdrawals from a super fund are tax-exempt after the age of 60, and these retirees depend on their SMSF for their income, this proposal will have a direct impact on the living standards of self-funded retirees who invest in shares and/or depend on their SMSF for their retirement income. There are several case studies in Appendix A that illustrate this point.

Financial experts insist a portfolio's asset allocation should become more conservative as people age. Older people should hold fewer growth assets like shares and more conservative assets like term-

deposits. The reason is clear: if retirees are trading in volatile share markets they could be selling their assets at really depressed prices with little opportunity to rebuild their capital. The crucial flaw in that advice is the assumption that all shareholders are traders. It also conveniently ignores the 80% fall in income from term deposits in the last decade.

Unlike professionally managed super funds which constantly sell assets to pay for pensions, SMSFs in retirement can generate income from the assets themselves, without the need to sell assets. This can continue until they need to pay a mandated pension that is greater than the income produced by the fund, but that is always at a time of their choosing. Therefore, their main concern is not the volatility of share prices but the volatility of their income. Volatility, expressed as a standard deviation for Australian shares is 19%. For dividends it is 1%. In that circumstance, the income delivered by Australian shares provides attractive yield, little volatility, and the tax advantages of franking credits. Some SMSFs generate sufficient income so that they are never forced to sell assets in volatile markets.

In the context of longevity risk, it is perfectly rational for those SMSFs to choose to tolerate the short-term volatility of share prices in order to benefit from secure, stable and growing dividend income from a diversified share portfolio.

## 3. If refundable franking credits are removed; whom it would impact and how; Implications for expected behavioural changes by investors

**Discussion Points:**

- Change the asset allocation
- Move to an Industry fund
- Make more use of accumulation funds

Many self-funded retirees are angry and feel betrayed at the proposed theft of a legitimate tax refund. They feel that SMSFs are the only target of this policy. They worked hard and sacrificed much, using the lawful means at their disposal at the urgings of previous governments, so that they would be independent of the taxpayer in retirement. They are proud of this independence, but this policy appears to encourage dependency. Self-funded retirees do not want welfare, they want to be self-funded retirees. Labor's proposal, far from affecting multi-millionaires, will directly impact middle Australia, people who choose to use an SMSF to prolong their financial independence.

This proposed policy discriminates against SMSFs in favour of industry funds. It discriminates against self-funded retirees in favour of age pensioners, and it discriminates against Australian equities in favour of other assets. That provides a clue to the likely responses.

### 1. Change the asset allocation

Many SMSF trustees will look to changing their asset allocation to become less dependent on Australian shares. How this benefits the Australian share market or economy has not been explained.

### 2. Move to an industry fund

Some SMSF trustees will seek to move their super to a retail or industry fund. Alarmed at the number of members with high super balances who depart to establish their own SMSF, some industry funds have made it possible to virtually run an SMSF inside an industry fund and promise that the refund of franking credits in the member direct option will continue under this policy.

Industry and retail super funds have many members in accumulation mode and some in pension mode. They also invest in a diversified range of assets such as commercial property and bonds that do not generate franking credits. These funds are single taxpayers paying tax on behalf of all their members. Clearly these super funds will have taxable liabilities in excess of their franking credits and are net taxpayers. They will not be affected because they do not generate excess franking credits, unless they have a large percentage of members in pension mode and/or a large asset allocation to fully franked shares.

Large SMSFs are in exactly the same position, particularly since 1 July 2017. Large SMSFs have been forced to transfer funds in excess super of $1.6m into an accumulation fund. These funds, too, will have tax liabilities that absorb their franking credits.

This policy will not affect multi-millionaires with large super balances because they will always have tax liabilities to offset against their franking credits. While pension funds with less than $1.6million get belted with this proposal with the loss of franking credit refunds, multi-millionaires can continue to use super as an estate planning tool.

These members who abandon their SMSF for an industry fund will no longer be trustees of their own fund, but they are promised they will receive all the franking credits generated by the shares they think they own in the "member direct" option. As they are not the trustee, these new members of the industry fund are then subject to the rules determined by the trustee. They may find that their "entitlement" to continued cash refunds for their franking credits is not set in law.

It is possible that there will be a wholesale flight to industry funds. This is clearly a desired outcome for industry funds and their trade union colleagues. Some cynics argue that this is the ultimate aim of Labor's proposal. What happens when the flight of SMSFs to industry funds overwhelms the fund's available franking credit balance to continue to pay all these new members is not explained.

**3. Make more use of accumulation funds**

In the absence of franking credit refunds, accumulation funds offer a better investment vehicle than pension funds precisely because they generate a tax liability. As we have seen, because a pension fund has a zero-tax liability, any franking credit generated by Australian shares will be removed. In an accumulation fund these franking credits can be used to pay some or all of the fund's tax liability.

The first option is for a retired couple to invite younger adult children into their SMSF. It is a single entity and pays tax on behalf of all its members. In that case, the franking credits generated by the parents in pension mode can be used to pay the tax liability generated by the younger members in accumulation mode. To be sure, there will still be no cash refund for excess credits, but the franking credits generated by the parents will be put to good use rather than merely handed back to government. This has the effect of boosting the children's super balances as their tax liability is paid for them. When it becomes possible for SMSFs to expand to six members, it is likely that no franking credits will be lost to the fund, but used to pay the tax liability of members in accumulation mode.

The other option is for a retired couple to transfer their total super from pension mode back into accumulation mode themselves. Again, this does not generate a cash refund for excess tax credits and the investment return is no greater than before. The major difference is that in accumulation mode there is no obligation for members to withdraw an increasing minimum amount each year. These retirees will no longer be forced to take out more money than they need, thereby also reducing their assets in tax-concessional super. This strategy is much more likely to leave an inheritance for the children than leaving it in pension mode.

If everyone adopted this strategy, the government would need to introduce a death tax on the total super (not just the concessional component) to claw back some of these concessions. That explains why it would be difficult to lift the tax rate of pension fund to 15% to be the same as accumulation funds. Nobody would then use a pension fund with its mandated minimum withdrawals.

## 4. If there are carve outs applied, what this will mean for additional complexity, uncertainty and fairness

**Discussion Points:**

- The incentive to qualify for the age pension
- Invest in your own name

All the taxpayers in the exempt group[3] will not be affected. Not-for-profit charities, churches and universities will not be affected because they are entitled to a range of tax concessions anyway. The inclusion in the exemption of unions and recipients of the Centrelink age pension, in whole or in part, is curious and suggests that this proposal has a political subtext as well as an economic imperative. That in itself is likely to cause considerable opposition on equity grounds.

### 1. The incentive to qualify for the age pension

From the government's point of view, the greater risk is that many self-funded retirees will arrange their affairs so that they qualify for the age pension and the refundable franking credits under the exemption.

The age pension is Australia's universal safety net. As a welfare payment it is an annuity that is paid for life and indexed to inflation for those who meet the age and residency requirements. Unlike other countries, it is targeted at the neediest with the expectation that those who have their own resources, will use them before they make a claim on government assistance.

The age pension is means tested against income and assets. Both tests are applied and the test that produces the lower pension is the one adopted. There are different tests for couples and singles, and there are different tests for people who own their own home, and those who pay rent. To illustrate the point, this analysis focuses on the assets test for a couple who own their own home. Couples in this category will receive the full pension of $35,916.40 per year if their assets are below $387,500.

Under the assets test, this pension is reduced by $3 per fortnight for every $1,000 of assets above this threshold. This means that if assets increase by $100,000 the pension is reduced by $7,800pa (26 fortnights x $3 x 100). The reverse is also true; if a couple can reduce their assets by $100,000 they will increase their pension by $7,800pa. This is a 7.8% rate of pension reduction, and unless their assets can earn 7.8% income there is an incentive to reduce assets to maximize their pension. Fewer assets mean more pension until their assets decline to $387,500 at which point they receive the full pension. A less aggressive taper rate of pension reduction would reduce this incentive.

It is important to note the actual income earned is irrelevant, as Centrelink "deems" all investments to earn the same return irrespective of the actual return. Any income that is more than the deeming rate is ignored for the means test.

[3] The exempt group is defined on page 7

The assets test upper limit for the age pension for a couple who also own their own home is $848,000. Once assets reach this limit, it means that the couple will receive no pension at all. They will also lose any concession cards associated with the age pension. For many, that is incentive enough to arrange their affairs to qualify for the age pension. The Labor policy on removing cash refund of imputation credits will only increase that incentive.

Assume a couple is eligible for the part-pension because their assets are $800,000. At this level of assets, they receive an annual pension of $3,741.40. Under Labor's proposal this couple will continue to receive a franking credit cash refund because they receive a part-age pension. Assume this couple tries to maximize income by investing in high-yield, fully- franked blue-chip shares such as those listed in the table below, and ALL their wealth is invested in this portfolio to simplify the maths. The current dividend yield on such a portfolio is around 5.6% Therefore, their dividend income is $44,800.

**Table 1**

**Possible basket of Australian fully-franked blue-chip shares**

| *Stock* | *Yield %* |
|---|---|
| ANZ | 5.62 |
| CBA | 5.99 |
| NAB | 7.15 |
| WBC | 6.67 |
| TLS | 6.98 |
| BHP | 4.73 |
| RIO | 5.01 |
| WOW | 3.73 |
| WES | 4.47 |
| **Avg.Yield %** | **5.60** |

Australian self-funded retirees are renowned for their love of the big four banks and Telstra, for the generous fully-franked dividends.

We have added BHP and RIO, together with Woolworths and Wesfarmers, to arrive at a typically favoured portfolio. This hypothetical portfolio returns a yield of approx. 5.6% (at October 2018), and we have used this yield in our calculations.

For simplicity, we have not included a cash component, so the portfolio gives a higher yield than if cash were included.

**We give two examples:**

**Our first couple has $800,000 to invest.**

Under the current rate of company taxation, the dividend represents 70% of the profit distributed to the shareholder and the company tax, which is also the franking credit, represents 30%. With a yield of 5.6% their dividend income is $44,800. If $44,800 represents 70% of the total income attributed to this shareholder, then the franking credit is $19,200 or 30% of the total income of $64,000. This ratio of 70:30 means that the franking credit is 42.86% of the dividend itself (30/70). How much extra income this represents to the taxpayer will depend on their exposure to fully-franked Australian shares.

This couple's annual income is:

| | |
|---|---|
| Age pension | $3,741.40 |
| Dividends | $44,800.00 |
| Franking Refund | $19,200.00 |
| **Total** | **$67,741.40** |

**Our second couple has $1,200,000 to invest.**

The couple with $1.2million also earns 5.6% and therefore their dividends are $67,200. They are not eligible for the age pension as their assets exceed the assets test. Under Labor's proposal they are also not eligible for any franking credit cash refund ***because they are not age pensioners!***

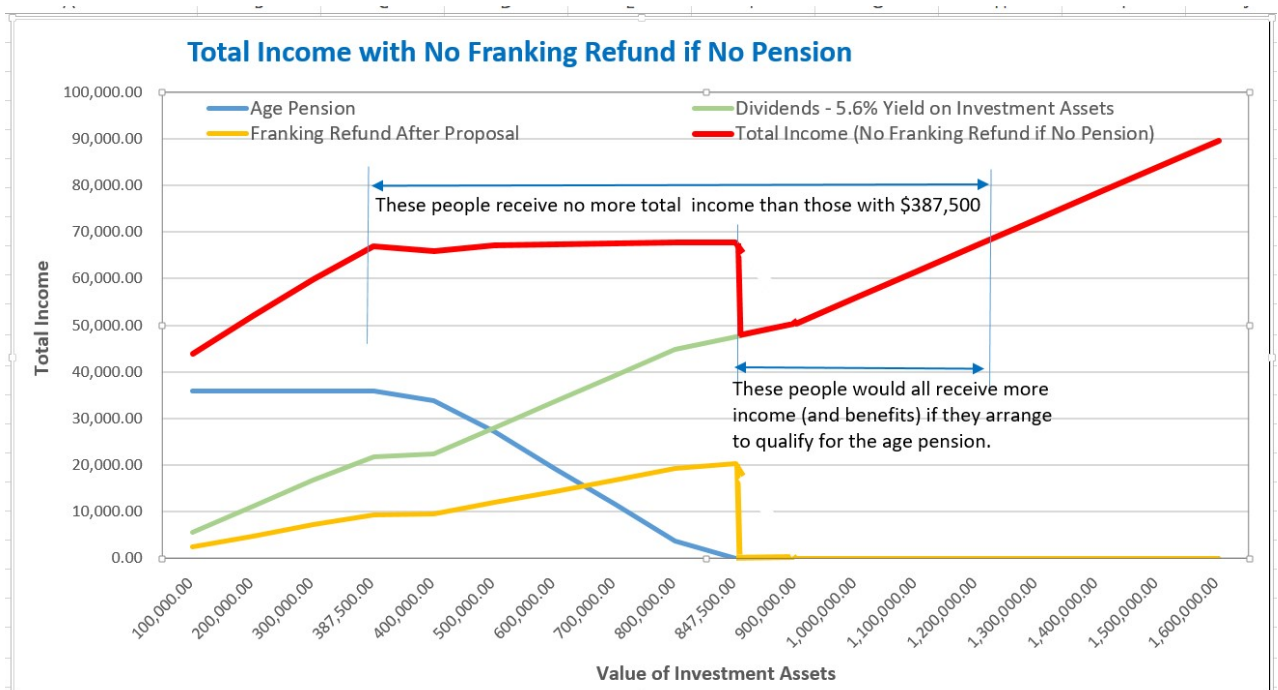
This couple's annual income is:

| | |
|---|---|
| Age pension | 0 |
| Dividends | $67,200.00 |
| Franking Refund | 0 |
| **Total** | **$67,200.00** |

Note: If franking credit refunds remain, this couple would also receive a cash refund of $28,800. That is the income lost to this couple under this proposal.

In terms of wealth the latter couple is obviously better off. However, in retirement, income is paramount to cover ongoing expenses. The couple with $1.2 million finds that although they have 50% more assets than the first couple, they have $541.40 **less** income each year. Clearly it is unrealistic to expect that these couples will have all their wealth invested in Australian shares, but it does demonstrate the double whammy of the loss of age pension combined with the loss of franking credit refunds for those who do not qualify for the age pension. The amount of lost franking credits will be determined by each portfolio's asset allocation to fully franked Australian shares, but it is clear that the effect is potentially huge, and each retired couple will need to do their own sums.

This analysis clearly shows that, if a couple's assets are above the age pension assets-test cut off and therefore denied the age pension as well as the franking credit refund, but below about $1.2million, this policy creates an enormous incentive for retirees to **increase their income by spending capital** so that they qualify for both the age pension and the cash refund of franking credits. Instead of encouraging people to be self-reliant in retirement, this proposal does the opposite.



**Notes to graph:**

1. With assets greater than $387,500 and a yield of 5.6%, the pension reduces at approximately the same rate as income increases.
2. Total income drops by 30% after assets exceed $848,000 due to loss of franking credits.
3. Total income does not recover to the same level as $387,500 in assets, until assets reach approx.$1.2million
4. The table of figures producing this graph is shown in Appendix C, page 40

Because the policy has a clear demarcation between those who will be eligible for the cash refund (age pensioners) and those who will be ineligible (self-funded retirees) with no taper or shade out area, it is easy to see that there will many self-funded retirees who just miss out but will be able to arrange their affairs so that they will be eligible for both the age pension and the refunds, thereby greatly increasing their income.

As the family home remains exempt from the assets test, it will be a simple matter for some couples to **upsize** their family home, thereby preserving their wealth for the future and also qualifying for both the age pension and the franking credit cash refund. This proposal will worsen housing affordability by increasing housing demand. Others will achieve the same result by simply spending some of their capital on personal items such as holidays (as the gifting rules prevent helping family members). Once spent, this capital cannot be rebuilt in retirement, and this has implications for how much can be contributed to aged care costs in the future.

How many people this involves, is difficult to say. It is instructive, though, that the assets test taper rate changed from 1 Jan 2017. This increased the pension reduction taper rate and reduced the asset test upper limit from over $1.17million to the today's limit of $848,000. We do know that the effect of that change was to remove more than 330,000 people from the age pension payroll.

Couples with assets between $848,000 and $1.17 million lost their part age pension in 2017 because they were considered too wealthy to need welfare assistance, and their standard of living dropped accordingly. Under this proposal, these couples will also lose their franking credit refunds because they are considered too wealthy to need a tax refund, and their standard of living will fall again. A perfectly rational response will be for them to arrange their affairs so that they again qualify for both the age pension and the franking credit refunds.

As we know the number of people involved, it seems reasonable to expect that this proposal on franking credits will *increase the number of age pensioners by more than 300,000.* It also means considerably more franking credits refunds to those self-funded retirees who will arrange their affairs so that they newly qualify for the age pension. That means more outlays and less revenue for the government at a time when the federal budget is already under considerable strain as more and more baby boomers claim the pension and call on aged care support.

## 2. Invest in your own name

We are told that self-managed superannuation funds with at least one pensioner or allowance recipient before 28 March 2018 will also be exempt from the changes, but that exemption does not apply after that date. We also know that if a couple has less than $848,000 in assets they qualify for the age pension at any time. If this proposal becomes law there will be no point for this couple to hold those

assets in an SMSF because the SMSF is not exempt if this couple become pensioners after that date, but if the assets are held by age pensioners in their own names, they will be exempt.

The rational decision then is to close the SMSF and invest in their own names. Their income is still likely to be tax-free due to SAPTO, and as age pensioners they will continue to collect their franking credit refunds. If the policy objective is to remove franking credit refunds from those “wealthy” SMSFs, it is easy to avoid. This is just another example of how a poorly thought-out proposal causes unintended consequences.

Even if the taxpayer is not eligible for the age pension, there may still good reason to close an SMSF and invest in their own name. As discussed above, a taxpayer can earn a high income and pay no extra tax because all the franking credits generated by the portfolio are absorbed in paying the tax liability. The capital required to earn that income puts the taxpayer over the assets test so they are not eligible for the age pension, but if they are going to have their franking credits refunds removed anyway, they can earn the same income investing in their own name as they would inside an SMSF without the administration cost, mandatory pensions or compliance obligations.

One clear consequence, intended or not, will be to encourage more people to close their SMSFs. Why SMSFs should be the target of this proposal is unclear. It is purely coincidental that industry funds, under the control of trade unions, dislike SMSFs intensely.

## 5. Reduced incentives to save and distortions to which asset classes are invested in and funds are used

**Discussion Points:**

- Discourage Australian Shares
- Move Super to Industry Funds
- Reduced Living Standards for self-funded retirees
- Encourage greater reliance on the age pension
- Loss of confidence in retirement planning

### 1. Discourages Australian shares

It seems clear that a large target group for this proposal are people who are not eligible for the age pension because their assets exceed the age pension assets test and who have assets below the $1.6m per member presently allowed in their SMSF. People with more assets than $1.6m in super will have money in accumulation funds that generate tax liabilities which absorb franking credits to pay their tax liability. Those with assets held outside super generate even more tax liabilities.

The effect of this proposal will be to actively discourage SMSFs from investing in Australian shares. If franking credits are no longer part of the risk/return equation these funds may move to other assets including international shares, property, and bonds as Labor clearly expects them to do. As the group most affected are SMSFs in pension mode, where the imperative is almost always the search for income yield, A-REITs produce high yield without franking credits, so it is possible that this proposal will lead to a bubble in commercial property.

As the demand for Australian shares falls, the market price of those shares can also be expected to fall. This has implications for all shareholders including managed funds and industry super funds because the market value of any portfolio (and the fees these portfolios generate) is determined by the product of the number of shares and the market price. Since capital gains tax is calculated on the difference between the purchase price and the sale price, this has implications for government revenue as well.

The extent of these effects is unknowable, and there are likely to be many unintended consequences. Therefore, Labor's claim that they have taken likely behavioural changes into account is just not credible. What is certain is that this proposal will be highly disruptive to financial markets.

### 2. Move super to industry funds

As noted above, one of the likely effects is that some or possibly many SMSF trustees will move their super to an industry fund. In the process it is likely that SMSFs will become a much less attractive investment vehicle to pay retirement income streams. It is likely to make industry funds even more dominant as superannuation providers and that they will to use that dominance through their voting power to influence the way individual corporations operate. There is already evidence of some industry

funds using their financial muscle to become players in mergers and acquisitions and also to dictate that some companies follow a politically correct, non-financial agenda.

With Industry funds there is largely no accountability as the members of the fund are not shareholders, and therefore they have no say on the actions of the trustees. As we have seen, almost any activity can be justified as being in the members' interests, including corporate boxes at major sporting events. With less competition from SMSFs we can expect even less accountability from industry funds.

### 3. Reduced living standards for self-funded retirees

This proposal will decimate the standard of living of self-funded retirees. Firstly, the effect of steadily rising minimum pension withdrawals is that at some point in time the income produced by the fund is insufficient to pay for the pension. Assets then need to be sold for cash to satisfy that pension requirement. If the fund income falls because it no longer receives the refund for franking credits, that time is brought forward. The bigger the differential between the inflow and the outflow, the sooner that the fund's assets are depleted. Many people outlive their super savings and fall back on the age pension. The loss of franking credit refunds simply hastens that date.

Secondly, if the fund produces more income than the minimum required because of the refund of franking credits, that additional income is discretionary. It can be spent, held as cash or reinvested. That can continue until the mandated minimum withdrawal is larger than the income produced. If the fund's income is reduced because of the loss of franking credit refunds, there is no discretion and retirees have much less cash to spend on everything. That lower consumer spending will be felt in every sector of the economy. This has particular relevance to charities that tend to collect more donations from older people.

Experts insist that retirees must be prepared to sell down their assets to fund their lifestyle. This approach focuses on a conservative portfolio as protection against market falls even if such a portfolio also reduces the gains as markets rise. Experts know that such a conservative portfolio also increases longevity risk, the risk that we outlive our money, but that is not their problem because the taxpayer is always there to provide the age pension. It is universal, guaranteed for life and indexed to inflation. For these advisors, it is the government's job to manage longevity risk, not theirs.

By contrast, self-funded retirees take longevity risk very seriously. They know that 5% of females will live to age 100, that 5% of males live to age 97, that as a couple they have a 70% chance that one of them will reach 90 and that aged care costs keep rising. They also know that the age pension provides a lifestyle to which not many aspire. Therefore, if retirees are going to avoid that fate, their income-producing assets need to last for a very, very long time. If they start liquidating assets too early they will not last the distance.

### 4. Encourage greater reliance on the age pension

By definition, any removal of a cash refund will mean a lower income for those who have come to depend on it. Franking credit refunds can provide substantial additional income in retirement because of the low marginal tax rates. At the zero-tax rate of SMSFs in pension mode, franking credits are worth an additional 42.86% of the value of the dividend alone. But unlike other taxpayers, retirees have little

opportunity to replace that lost income by returning to work. Sooner or later that will impact their reliance on the age pension.

In the short-term the removal of franking credits increases reliance on the age pension because it removes the incentive to save. If a couple with $1.2 million can generate no more income than the couple with half that amount, there will be no incentive to save. Removal of franking credit refunds will impoverish all retirees because few future retirees will have the incentive to work hard to be self-reliant if they see their savings being confiscated.

In the medium-term there will be even greater pressure on the age pension as the removal of franking credit refunds drastically reduces the return generated by SMSFs supporting self- funded retirees, and their super savings will expire that much sooner. That means they will claim the age pension far earlier. If franking credits are confiscated now, there will be a need to pay more age pensions later.

It points to a larger problem. Australia faces an increasing demand for welfare which will place a greater burden on a shrinking taxpayer base. The problems that Australia has with its Baby Boomers in retirement have only just begun. The post-war baby boom was from 1946 to 1965 when it ended with the introduction of 'the Pill'. The first baby boomers reached retirement age in 2011 and their numbers will keep rising. According to the 2015 Intergenerational Report, the baby boomer numbers do not peak until 2027 when the majority of boomers turn 65.

The solution it seems, under Labor's proposal, is supposed to make rich retirees subsidise the poorer ones. Perversely, this "solution" will actually exacerbate the problem. Under this proposal, the poor and the rich are protected, and the middle class gets slugged so that they too become poor! It does not seem very clever to have a policy that guarantees that we have even more age pensioners reliant on the tax-payer both now and in the future. It seems especially irresponsible that the truly wealthy will not be affected at all while incentives are created for everyone else to impoverish themselves.

Labor has not explained why any government would want to encourage over-investment in the family home, encourage the expenditure of capital that could be available to support age care, and commit to more government outlays on the age pension while at the same time collecting less revenue.

**5. Loss of confidence in retirement planning**

It is abundantly clear that the removal of franking credit refunds will reverberate through the wider community. It will be very disruptive to the retirement planning of thousands of retirees and would-be retirees. There is a real sense of betrayal because these people planned their retirement in good faith within the lawful statutes available, only to have all their plans overturned by a capricious decision.

The age pension is an annuity, and age pensioners do not need to worry about market risk, inflation risk, longevity risk or legislative risk. By contrast, self-funded retirees must manage all these risks and then accumulate more than $1.2 million as a couple to be just slightly better off than age pensioners. Why would anyone bother? Many do, because they aspire to a higher standard of living than that provided by the age pension, they enjoy freedom of choice and are proud of their independence. Achieving that level of savings does not happen without effort and planning over a long period of time.

The constant changing of the rules and regulations around retirement make that planning extremely difficult and disheartening. It also discourages young people from making voluntary contributions to super, and that has long-term implications for the pressure on the age pension.

Having put in that effort, and forfeited considerable consumption along the way, at the urgings of several governments, there is now real anger that instead of community acknowledgement for that effort and sacrifice, self-funded retirees are now demonised as "rorting" franking credits and are somehow getting a special deal unavailable to ordinary folk.

Australia desperately needs a coherent retirement income policy that comprehensively integrates the age pension, superannuation, and private savings in a way that encourages and supports self-reliance in retirement to ease the burden on the tax payer. It needs to consider effective marginal tax rates as benefits are withdrawn, and it should not include incentives for retirees to spend their own capital in order to become eligible for benefits. The first and easiest step to promoting self-reliance in retirement is to allow all self-funded retirees to manage their retirement as planned, and to leave franking credits refunds undisturbed.

This Labor proposal is the absolute opposite of a sound integrated retirement income policy. It introduces disincentives to save. By introducing very steep marginal tax (vertical) rates on the withdrawal of benefits it creates incentives for retirees to spend capital which could be used to support their income and aged care. It actively encourages increased dependence on the tax payer. It makes an already complex and contradictory system much worse, leaving retirees even more at the mercies of financial planners.

## 6. The reliability of providing a sustainable revenue base over the longer term.

**Discussion Points:**

- Number of shares and the value of franking unchanged
- Labor's figures are misleading
- Much of the possible tax from super pensions is already being collected
- Potential source of revenue

It is impossible to predict how much revenue this proposal will collect, but it is unlikely to be anything like the forecasts, especially when the likely avoidance behavioural changes are considered.

### 1. Number of shares and the value of franking unchanged

If a shareholder cannot use these franking credits, those shares will likely be sold and likely bought by taxpayers who can use these credits. As there will still be the same number of shares in circulation and still the same value of franking, it simply means that the franking credits will be used by people who ***can*** use the tax credits to offset their tax liability.

Similarly, if industry funds attract more members with large balances, there will still be no more franking credits in excess to the tax liability that can be confiscated by the government. If the excess credits continue to be used to pay a tax liability there will be no extra revenue to the government from people who previously received a refund but, under this proposal, will not.

If a couple receives the age pension because their assets fall under the assets test cut-off, they will also receive their franking credits. If one dies and the survivor inherits all the assets they will probably find that they then exceed the assets test cut-off so that they become ineligible for the single age pension. They would then also lose their franking credit refunds. That extra revenue hardly explains the revenue numbers that Labor used to explain this policy.

According to the Opposition, the cost of refundable franking credits to revenue is approaching $6 billion each year. According to Labor, the figures were verified by the Parliamentary Budget Office. There is no reason to doubt those figures, but it is clear that those figures are based on the superannuation conditions that applied in 2014-15. The figures since July 2017 are very different.

### 2. Labor's figures are misleading

Mr Bowen used an extreme example to embellish his case. As the franking credit only ever represents 30% of the total income from shares, an SMSF that collects a refund of $2.5 million in franking credit refunds would need to collect $5,833,333 in dividends to generate those franking credits. If we assume a dividend yield of 5%, it assumes that this SMSF has a share portfolio of over $116.6 million! This is hardly a typical example and strains credibility.

SMSFs in pension mode of that size may have been possible in 2014 when these figures were collected. It is certainly not possible since 1 July 2017.

Since that date, it is not possible to hold more than $1.6 million in the tax-free pension area. Any excess must be removed to accumulation mode where earnings are taxed at 15%. That same SMSF today would have $1.6million in zero-taxed pension mode and $115 million in accumulation earning 5% dividends and about 2% from franking credits assuming it was 100% invested in fully-franked shares. This income of $8.05 million is then taxed at 15%. This SMSF would now be paying $ 1,207,500 in tax on income received from assets in accumulation mode instead of receiving a cash refund of $2.5million from all the assets solely in pension mode. Labor's proposal is unlikely to generate more tax revenue than is already being collected.

### 3. Much of the possible tax from super pensions is already being collected

This example may not be typical, but it does illustrate that large SMSFs will be able to use their franking credits to pay some or all of their tax liability. It also underscores the massive transfer of super money from the tax-free pension mode to the taxable accumulation mode that has occurred since 1 July 2017. An early analysis of the effect of this decision shows that it has already had a dramatic impact. According to Olivia Long (cuffelinks.com.au/smsfs-hit-by-loss-of-tax-free-status-and-franking-refunds/ [16 August 2018]) this decision is directly responsible for the increase of money in accumulation phase rising from $222 billion in March 2017 to $422 billion in June 2018, an increase of 90%.

According to this analysis, 31% of super assets were held in pension phase and 45% were held in the mixed phase in March 2017. As at June 2018, only 14% of assets remain in the tax-free pension phase, while the mixed phase has jumped to 57%. Moreover, the policy has increased the tax revenue from super by $1.5 billion! This suggests that all the assets in excess of what is required to fund a comfortable retirement are no longer in the tax-free pension mode, but are already the source of considerable taxation. It also demonstrates that the bulk of the revenue available by taxing large SMSFs that Labor hoped for with this proposal, has already happened. Labor is too late. The SMSF tax-returns for the 2017-2018 financial year will bear this out.

### 4. Potential source of revenue

Under present rules, a retired couple (over age 65) can have $3.2 million in their super pension fund ($1.6m each) with zero tax on its earnings, but subject to increasing mandatory pension payments. A pension withdrawn from this fund is also tax-exempt. It does not appear on a tax return. Any income earned outside super is then subject to the normal tax-free thresholds, Couples over age 65 are entitled to claim SAPTO which gives them a tax-free threshold of almost $58,000. If this represents 7.25% income (including franking credits), they can hold another $800,000 in a share portfolio outside super and also pay no tax on that income. In other words, they can have $4 million invested for a very comfortable retirement and pay no tax.

In addition, they can hold an *unlimited* amount in an accumulation fund if they were fortunate enough to contribute that money before 2017, with no obligation to withdraw any money over their lifetime. The income in that fund is concessionally taxed at only 15%. At the end, the death benefit is then only concessionally taxed, if at all. That is a very concessional way to accumulate an inheritance for one's beneficiaries.

The changes in 2017 compelled members with super savings in excess of $1.6 million to transfer that excess to an accumulation fund where it is now taxed at 15%. How much extra tax would be collected if those super savings, in excess of what is required for a comfortable retirement ($1.6m each), were removed from the concessional super space completely after age 65?

## 7. Conclusion

It is very clear that this proposal takes no account of the avoidance behaviour that taxpayers are likely to engage in to defeat this new double taxation of dividends from Australian shares for selected taxpayers. It also fails to take account of the far-reaching changes that happened to superannuation in 2017.

This proposal does not affect multi-millionaires as claimed, but middle Australians, people who worked hard to be self-reliant in retirement using the lawful means at their disposal. Worse, it is likely to substantially increase the demand for the age pension, placing a greater burden on the taxpayer.

The proposal is ill conceived, damaging to both financial markets and the trust that people need to engage in long-term retirement planning. It is discriminatory and will collect very little revenue. It has echoes of Labor 's mining tax.

## 8. Recommendations

We make the following recommendations:

1. This proposal to remove the cash refunds for excess franking credits should be discarded because it will be grossly unfair, extremely discriminatory, retrospective, and ultimately damaging and ineffective.

2. If that is not possible, all taxpayers on marginal tax rates below 30% should be exempt, because otherwise they will be paying tax on income they never receive.

3. In particular, superannuation funds in pension mode should be exempt from this policy to allow self-funded retirees to remain self-funded retirees and remain independent of government welfare for as long as possible. The benefits of a zero-tax rate in retirement have already been limited by the requirement to hold any excess above $1.6million per member in a taxable environment.

4. Parliament should develop a long-term, comprehensive retirement income policy that incorporates the age pension, superannuation, and private savings and supports self-reliance in retirement so as to ease the burden on the tax payer. In addition to simply looking at costs, it should look at incentives for retirees and would-be retirees to adopt certain behaviours and how those behaviours affect government costs in the long-term.

## 9. Impact on AIA members

The Australian Investors Association (AIA) is Australia's leading financial education non-profit organisation, helping its members to make improved investment decisions. The AIA does not provide advice. It provides information and education to its members to help them become better investors.

The Association has approximately 1500 members nationwide drawn from all walks of life, brought together by a common interest in achieving improved investment returns. As a group, our members can be characterised as very determined to be self-directed investors. Many members are retired, and they have the time and resources to research and pursue their interest in investing. Many do not use an adviser because of the demonstrated conflict of interest, and many do not use a stock broker as they prefer to conduct their own research. Many members have been successful independent investors for a long time, achieving handsome returns.

As self-directed investors, our members are fully aware of the tax concessions offered by superannuation, and many use a self-managed super fund (SMSF) because it gives them control over their financial future. An SMSF also extends their retirement savings for as long as possible, thereby helping to manage longevity risk and to delay their dependence on the age pension. Consequently, our members are well informed about changes to policy and legislation as they impact on investment outcomes.

Age pensioners are unaffected as they are protected by the exemption to the policy, but most AIA members do not qualify for the age pension because their assets make them ineligible. At the other end of the spectrum, extremely wealthy members who hold more than $1.6million per member in their fund, are now required to hold the excess in an accumulation fund which is taxable, and therefore these funds can use their franking credits to pay their tax liability. They too will not be affected.

Many members of the AIA will be very harshly treated under this proposal as the case studies from our members that follow, attest. Self-funded retirees who hold less than $1.6million per member in an SMSF, are caught in the middle. They will typically have an SMSF that is solely in pension mode and therefore it has a zero-tax rate and no tax liability to absorb franking credits. Therefore, ***any*** Australian shares in such a fund will generate franking credits that are excess to a zero-tax liability. Consequently, their SMSF will lose ***all*** of its franking credit cash refunds under this proposal, and this has a direct negative impact on the living standards of many AIA members who draw their retirement income streams from such a fund. The loss of income can be as high as 30%, depending on the fund's allocation to shares.

In addition, those self-funded retirees whose assets are held outside super and do not qualify for the age pension will also lose all of their existing cash refunds and have very high effective tax rates on their investment incomes.

This treatment is very unfair. These members have already set their retirement plans based on the existing laws. Changing these laws now, without “grandfathering”, is very unfair and retrospective. These members are not in a position to return to work and start their retirement again based on a new set of rules.

Franking credit refunds have been a legitimate feature of the taxation landscape since 2001. This is not a loophole that is exploited by the wealthy, but a legitimate refund of excess pre-paid tax.

Many of our members are not wealthy, but through frugal and prudent saving they save the taxpayer the cost of their age pensions every year. Their savings have replaced the age pension as the government has encouraged them to do.

They are now being unjustly punished for being self-funded retirees!

## 10. Appendices

### Appendix A – Case Studies

The following case studies are some of the stories of AIA members. Only the names have been concealed.

**Case Study 1.**

*I would like to add our voices (my wife and I have a fully **self-funded** and managed Super fund) to the growing concern about Labour's impending assault on Franking Credits.*

***Franking Credits represent about $15k per annum** of otherwise modest annual income. Removing this would be like a direct cut to our pensions.*

*Unless Labour intend to put some sort of ceiling on the lower level of Franking Credits allowed - eg if your credits do not exceed say, $50k - then we will be vehemently voting against them!!*

*We have worked and saved very hard and frugally for a long time to get to the point of being financially self-sufficient - so we do not expect any govt handouts - but we rely on the existing superannuation rules staying intact to continue to do so!*

*Regards, David P.*

**Case Study 2.**

*My wife and I (both in our 70's) downsized our housing a couple of years ago and do not qualify for a government pension.*

*Our SMSF is under professional management through our stockbroker of 30+ years standing.*

*The latest statement for our SMSF shows:*

- *funds under management <$700k*
- *estimated annual income about $30k **plus estimated franking credits about $10k***

*We have no other income except interest on about $200k (surplus from our housing change). Our home is the only major asset.*

*Both of us have significant medical conditions and are under regular supervision and treatments.*

*Thus, franking credits are clearly of very great value to us.*

*Regards  Mal A.*

**Case Study 3.**

*This decision to deprive me of imputed credits after I have set up my fund according to the existing rules, motivates me to take some expensive world trips so that my balance is reduced to the $500,000 mark so that I can collect a single part-age pension.*

*I remind you of the fact that the reason I set up a Self-Managed Super Fund in the first place was because of my lack of trust of financial planners at the time. This has been well and truly verified in the latest Royal Commission.*

*I am now 70 and live modestly, but comfortably on my super pension. I have never owned a new car in my life and live in a modest suburb of the Central Coast.*

*The Labor party's intention to stop imputed credits for my super fund will* ***deprive it of approximately 20 percent of its income*** *and will only hasten me towards a government pension.*

*I find it misleading and am greatly insulted when I hear Bill shorten claim that DIY Superannuation trustees are wealthy millionaires. I am sure there are wealthy people with Self-Managed Superannuation Funds, but I am sure there are many like myself who are quite modest in wealth and assets.*

*There would be an outcry if the old age pension was reduced by 20 percent. Please consider the thoughts and ideas I have presented when considering this bill.*
*Regards. Peter S.*

**Case Study 4.**

*My SMSF's imputation credit refund for the last financial year was $30588.73 It is a similar amount each year so unless there are unexpected dividend downgrades this year it should be a similar number next year.*

*After 43.5 years of continuous time in the workforce from age 15 and 42.5 years of that time as a paid-up union member, the Labor party wants to shaft us for not being connected to the welfare system. The last 33 years were as a police officer serving the community. Compulsory retirement at age 60 for police so I had no ability to stay on as I would have liked to.*

*The impact for us of the removal of franking credits is a reduced standard of living. We maintain private health insurance and I hope to always be covered privately, but who knows how this will all pan out. Without franking credits, health insurance premiums account for 8.5% of our unfranked income.*

*We take on an amount of risk by investing privately and the end result is we make no demands on the government for any form of pension payment. Removal of the imputation credits leaves us with an income that covers our living expenses with only few dollars to spare.*

*I have read the Future Fund is exempted and last financial year was refunded $817 million in franking credits. I imagine it will be much more again next year. I believe the Future Fund pays politicians defined benefit pensions as well as commonwealth public servant pensions. So, politicians and senior public servants make decisions that clearly discriminate against self-funded retirees knowing those decisions will never affect their own pension outcomes.*

*Regards Steve A.*

**Case Study 5.**

*I would like to let you know of my situation and how I and my wife will be affected. I retired from full time work in July 2007 at the age of 61. My wife has never worked since marriage 48 years ago and we have raised our 4 children.*

*For 10 years prior to retirement we saved 20% of my gross income (from average income work). Most of the savings were invested in the share market.*

*We established our SMSF in March 2003 as I did not have trust in the financial planning industry. The SMSF went to pension mode in 2007.*

*We are not "rich" and have always saved and paid upfront for most things.*
*Our SMSF assets at 30.6.18 is as follows (as per the 17/18 tax return)*

| | |
|---|---|
| *Shares* | *505,377* |
| *Listed unit trusts* | *61,175* |
| *Cash* | *325,529* |
| *Other* | *32,240* |
| *Total SMS* | *$ 930,502* |

| *Income 2017/18* | *from SMSF* | |
|---|---|---|
| *Dividends Shares* | *27,674* | |
| *Property Trusts* | *1,936* | |
| *Interest on cash* | *6,375* | |
| *Total SMSF Income* | *35,985* | |
| *Franking Credits* | *11,484* | |
| *Total income* | *$ 47,469* | *(inc. Franking Credits)* |

*Our total assets (excl. home) at 30.6.18 were $ 1,014,588 so we are not eligible for a Centerlink age pension.*

*The loss in Franking Credits will result in a reduction to our annual income of 24.19% from $47,469 to $35,985 which is a joke. We might as well spend up and get on the pension.*

*Regards David M*

## Appendix B – The myth about Costello's super generosity

An article by Jon Kalkman, originally published in Cuffelinks 6 June 2018

It's apparent from comments posted on Cuffelinks (and elsewhere) that many people regard tax-free superannuation after the age of 60 as overly generous. They claim that tax-free super introduced in 2007 by Treasurer Peter Costello forfeited tax revenue making the system unsustainable in the long term. It is time that myth was put to rest.

### Types of contributions

Let's start with the basics. There are two types of contributions to super. Concessional contributions are made before tax is paid, such as salary sacrifice, employer contributions and contributions on which tax deductions are claimed. Non-concessional (or after-tax) contributions include sums on which tax has already been paid such as the proceeds of the sale of an investment property or an inheritance or personal savings. Concessional contributions are popular because they save tax, but they may have possible tax implications later.

On retirement, the important metric is the proportion (not the amount) of super that is made of concessional and non-concessional contributions. Before the changes brought in by Peter Costello in 2007, the tax paid on your super in retirement was determined by these proportions. Today, if you access your super before age 60, these tax arrangements are still in place and determine the tax payable. And even today, everybody's tax liability on their death benefit before any money is paid to beneficiaries is determined by these same proportions.

### Taxing of withdrawals based on proportions

Costello's changes made all super tax free after age 60 for those who are fully retired (or more precisely, those who 'ceased an employment arrangement' after the age of 60). Therefore, these proportions have little relevance if retirement is postponed until age 60 or the super fund is exhausted before death. To check whether Costello's tax-free super after 60 is overly generous, consider how the tax system works and how little tax was paid on super in retirement before 2007. Tax on super in retirement only ever applied to the concessional portion of the fund, or that portion that claimed tax concessions in the contributions (accumulation) stage.

Let's assume George today is over age 56 but under age 60. He can access his super, but his super is taxable. This treatment applied to everyone before 2007.

If George retires with $1 million in super made up of $800,000 of employer and salary sacrifice contributions and $200,000 made up of after-tax contributions, then all withdrawals from his super, both pensions and lumps sums, are in the proportion of 80:20. With lump sums, everyone is entitled to take a once-only withdrawal from super of $200,000 as a concessional allowance. If George were to take a lump sum withdrawal and pay no tax, he could take $250,000 because $200,000 (80%) is his concessional allowance and $50,000 (20%) is seen as the return of his own money that he has already paid tax on.

Please note that these proportions are only examples and everyone will have their own unique proportions. Surprisingly few people know what their proportions are.

Super pensions come with a 15% tax rebate which is compensation for the 15% contributions tax and the 15% tax paid on earnings in accumulation phase. Tax concessions on super pensions were designed to encourage retirees to take their super as an income stream rather than a lump sum which could be spent before claiming the age pension.

These same proportions apply to any super pension George may take. In this example, he can take a pension of $54,000 and pay no tax. His concessional component of the pension is 80% or $43,250 and his non-concessional component is 20% or $10,750. His non-concessional component is tax free because it is the return of his own money. And the concessional component is also tax free because the 15% rebate on $43,250 is $6,487.50, which cancels out the tax liability of $6,468.

Even if George took a larger pension he pays very little tax. If the pension was $80,000 his non-concessional component is $16,000 (20%) tax free, and his concessional (taxable) component is $64,000 (80%). The tax on $64,000 is $13,627 but it comes with a tax rebate of 15% which is $9,600. His net tax is slightly more than $4,000 on a pension income of $80,000 when workers on the same income pay in excess of $19,000 in tax.

**Restrictions will limit large balances**

With the restrictions on concessional contributions (currently $25,000 per person including both employer and salary sacrifice contributions), it is impossible to accumulate large super balances by concessional contributions alone. It requires the contribution of large amounts of after-tax (non-concessional) contributions from the sale of properties or businesses or from after-tax savings. Before 2007, there was no limit on after-tax non-concessional contributions. With large super balances, it is likely in future that the proportions in retirement super will be heavily weighted in favour of non-taxable benefits.

For the sake of comparison, let’s assume that George’s proportions are now reversed. His concessional contributions are now 20% and his non-concessional contributions are now 80% of his super balance. His tax-free lump sum now is $1,000,000 made up of $200,000 (20%) as his concessional allowance and $800,000 (80%) as the return of his own money.

Even though at his age, his super is subject to tax, he can now take a tax-free pension of $216,250 because we know that 80% or $173,000 of that is tax-free as it is the return of his own money and $43,250 (20% concessional) is taxable. But the taxable portion comes with a 15% rebate which cancels out the tax payable, as before.

**Death benefits tax**

The tax on death benefits uses the same process. The tax only applies to the concessional component. Therefore, the higher the concessional proportion, the more tax that is payable. The death benefit tax is 15% plus the 2% Medicare levy on the taxable portion. If the super death benefit is an insurance payout, the tax is 30% plus the Medicare levy.

If George died with $1 million in his super and his concessional component was 80% of the total, the tax payable before his beneficiaries received any money would be 17% of $800,000 or $136,000. By contrast if George’s concessional component was only 20%, the tax would 17% of $200,000 or $34,000.

Clearly, the larger the non-concessional proportion, the lower the tax payable on death. Large super balances are more likely to contain a high proportion of non-concessional super.
The message is clear: benefits paid from small super balances pay little or no tax and, by definition, large super balances that contain large non-concessional components also pay little or no tax on their benefits.

**Costello forfeited little tax revenue**

It was easy for Costello to make super tax-free after 60 because his decision forfeited very little tax revenue and at the same time proved politically popular. No government since 2007 has contemplated reversing that decision. Such a step would be politically unpopular and it would generate little revenue.

It also explains why Treasurer Scott Morrison has capped the amount that can be held in the pension area where the fund income is tax-free. By forcing amounts in excess of $1.6 million into accumulation phase, the government at least collects tax at the rate of 15% on income earned from both components of a super fund, whereas before 2007, the tax only applied to the concessional component.

Whether that $1.6 million cap is too generous is another discussion but a nostalgic return to the golden era before Costello's changes would generate little or no tax from those funds with large super balances. In fact, that tax regime would collect less tax than the present system.

## Appendix C – Income calculations (pension, dividends and franking credits)

### C.1 – Example with a dividend return of 5.6%

| | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Imputation Credit | 0.4286 | | | | | | | | | | | | | | | | |
| | Yield on Investment Assets | 5.60 | % | | | | | | | | | | | | | | | |
| **Investment Assets** | **100,000.00** | **200,000.00** | **300,000.00** | **387,500.00** | **400,000.00** | **500,000.00** | **600,000.00** | **700,000.00** | **800,000.00** | **847,500.00** | **900,000.00** | **1,000,000.00** | **1,100,000.00** | **1,200,000.00** | **1,300,000.00** | **1,400,000.00** | **1,500,000.00** | **1,600,000.00** |
| Age Pension | 35,916.40 | 35,916.40 | 35,916.40 | 35,916.40 | 33,849.90 | 27,141.40 | 19,341.40 | 11,541.40 | 3,741.40 | 36.40 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dividends - 5.6% Yield on Investment Assets | 5,600.00 | 11,200.00 | 16,800.00 | 21,700.00 | 22,400.00 | 28,000.00 | 33,600.00 | 39,200.00 | 44,800.00 | 47,460.00 | 50,400.00 | 56,000.00 | 61,600.00 | 67,200.00 | 72,800.00 | 78,400.00 | 84,000.00 | 89,600.00 |
| Franking Refund Before Proposal | 2,400.00 | 4,800.00 | 7,200.00 | 9,300.00 | 9,600.00 | 12,000.00 | 14,400.00 | 16,800.00 | 19,200.00 | 20,340.00 | 21,600.00 | 24,000.00 | 26,400.00 | 28,800.00 | 31,200.00 | 33,600.00 | 36,000.00 | 38,400.00 |
| Franking Refund After Proposal | 2,400.00 | 4,800.00 | 7,200.00 | 9,300.00 | 9,600.00 | 12,000.00 | 14,400.00 | 16,800.00 | 19,200.00 | 20,340.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Total Income Before Proposal** | **43,916.40** | **51,916.40** | **59,916.40** | **66,916.40** | **65,849.90** | **67,141.40** | **67,341.40** | **67,541.40** | **67,741.40** | **67,836.40** | **72,000.00** | **80,000.00** | **88,000.00** | **96,000.00** | **104,000.00** | **112,000.00** | **120,000.00** | **128,000.00** |
| **Total Income (No Franking Refund if No Pension)** | 43,916.40 | 51,916.40 | 59,916.40 | 66,916.40 | 65,849.90 | 67,141.40 | 67,341.40 | 67,541.40 | 67,741.40 | 67,836.40 | 50,400.00 | 56,000.00 | 61,600.00 | 67,200.00 | 72,800.00 | 78,400.00 | 84,000.00 | 89,600.00 |
| **Policy Impact** | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | -21,600.00 | -24,000.00 | -26,400.00 | -28,800.00 | -31,200.00 | -33,600.00 | -36,000.00 | -38,400.00 |

**This example is our hypothetical typical portfolio. (see page 18)**

The points to note are:

1. At the **8%** total rate of return (5.6% dividend plus franking), and commencing from $387,500 in assets invested, each additional dollar of income results in an equal loss of pension.

2. Unless the pensioner couple has more than $1.2 million invested, they would be better off on the age pension. At the $1.2 million level, the income is $67,200pa which is the same as the pension plus assets of $387,500.

3. Once the asset value exceeds $848,000 the income falls by 30%. Another huge incentive to reduce the assets below $848,000 and claim the pension.