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Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Submission to the Re:think Tax Discussion Paper

Warakirri Asset Management Pty Ltd (Warakirri) is responding to discussion question 25 of the Re:think Tax Discussion Paper: "Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?"

Introduction

Warakirri believes that Australia's dividend imputation system continues to serve Australia well. Since franking credits were introduced in 1987, Australian investors have benefited from a fairer tax system. The dividend imputation system has eliminated double taxation and has allowed investors to be taxed at a rate that is consistent with their respective tax status.

Changes to the dividend imputation system in the early 2000s made franking credits refundable. This change allowed for lower tax rate investors (charities, superannuation funds, and investors on lower marginal tax rates) to receive a cash payment for the difference between their individual tax rate and the franked rate of any dividend income. Before franking credits become refundable, low tax rate investors were effectively taxed at the corporate rate on Australian dividend income. Making dividend imputation credits refundable has benefited Australian investors that have a low marginal tax rate, including eligible charitable and superannuation investors.

Australia's dividend imputation system is simple

Australia's dividend imputation system continues to serve Australia well because of its simplicity: for every 70 cents of dividends received by an investor, a tax credit of up to 30 cents can be attached to compensate an investor for any Australian corporate tax already paid. As illustrated by Table 1, other countries' systems of dividend taxation do not provide the same simplicity as the Australian imputation system.

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Table 1 – Survey of dividend tax regimes in selected OECD countries

United States, Denmark, Japan, Poland, Portugal, Spain, Switzerland	Dividend income is taxed again at preferential rates (for example, compared to interest income) at the shareholder level.
United Kingdom, South Korea	Dividend tax credit provided at shareholder level at a lower rate than the corporate rate.
France, Finland, Italy, Luxembourg, Turkey	A portion of the dividend is taxed again at the shareholder level.
Norway	No shareholder taxation of the risk-free return.

Source: Re:think Tax Discussion Paper

Franked dividends are not the preferred mode of return for higher tax rate investors

It is worth highlighting that franked dividends are not the preferred mode of return for all investors. For investors on the highest marginal tax rate, one dollar of discount capital gain is worth more on an after-tax basis than one dollar of fully franked income. The opposite is true for eligible charitable and superannuation investors, where the after-tax return for one dollar of fully franked income is worth more than one dollar of discount (long term) capital gain. Because of this, franking credits are of significant benefit to eligible charities and superannuation funds.

The refundability of franking credits is a positive attribute of Australia's dividend imputation system

Since the release of the Re:think Tax Discussion Paper, the Australian media has focused significant attention on the refundability of dividend imputation credits for investors with a low tax rate. Some media coverage has suggested that the refundability of imputation credits is inequitable. Warakirri disagrees with this assessment and believes that the refundability of franking credits is a positive attribute of Australia's dividend imputation system.

As stated earlier in this submission, not-for-profit groups have benefited from the refundability of franking credits. Eligible not-for-profit groups are provided with a preferential tax status (i.e. tax exempt) to help support the charitable work they do throughout Australia. The combination of a tax exempt status and the refundability of franking credits have provided not-for-profit groups with a higher return from Australian equity investments than would otherwise be achieved. Removing the refundability of franking credits would be detrimental to many not-for-profit groups that heavily rely on investment income to fund their charitable work.

Almost all working Australians have a superannuation account and will one day benefit from a retirement that is part funded via the refundability of franking credits. Superannuation funds are provided with preferential tax status to incentivise and assist Australians to save for retirement. The combination of a preferential tax status and the refundability of franking credits help superannuation accounts generate a higher return from Australian equity investments than would otherwise be the case. As such, franking credits are of universal benefit to working Australians. Removing the refundability of franking credits would be detrimental to the future retirement savings of Australian workers.

One argument for removing the refundability of franking credits is that superannuation accounts with very high balances receive an inequitable benefit from the refundability of dividend imputation credits. There are approximately 70,000 Australians with superannuation account balances above $2.5 million.[1] According to The Association of Superannuation Funds Australia (ASFA), $2.5 million represents the threshold where superannuation accounts can be considered 'very high'; accounts above $2.5 million generate an income close to twice the 'comfortable' income in retirement.[2] Based on ASFA's assessment of 'very high' account balances, providing preferential tax treatment to investors with superannuation balances above $2.5 million can be argued as being inequitable. However, Warakirri believes that any inequality is due to superannuation specific taxation policy rather than a fault with Australia's dividend imputation system.

Conclusion

Australia's dividend imputation system, and specifically the refundability of imputation credits, is a well-entrenched tax system in Australia. It is a simple system when compared to the taxation regimes in some other countries; it prevents double taxation; and improves the investment returns for Australia's not-for-profit groups and superannuation funds. The dividend imputation system results in Australian investors paying their marginal tax rate on investment income, which is a fair outcome.

Yours faithfully

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[1] Ross Clare, "Superannuation and high account balances," *The Association of Superannuation Funds Australia*, April 2015, 3.
[2] "Keeping to the facts in the super tax debate", ASFA Statement: 17 April 2015.