Election 2019 – Franking credits

# Why is this an issue for women?

* Media statements (Media Release 19 March 2019) and the report of the Inquiry into Franking Credits (Standing Committee on Economics, 2019 p16 ) have expressed the view that refundable franking credits benefit women more than men. With respect, we do not agree with this assessment.
* Security in retirement, particularly financial security, is a matter that concerns many women.
* 92% of Australians will not be affected by this policy, but 16% of Australians over the age of 65 will be affected by this policy.
* Women are more likely than men to be receiving the Age Pension. If recipients of government pensions and allowances are allowed to continue to receive franking credit surpluses, these women would not be affected by a change in the law. This excludes 320,000 individuals (28% of taxpayers directly affected) and 20,000 SMSFs (8% of funds directly affected) (PBO, 2018a).
* In respect of SMSFs, 52.6% of members of SMSFs are men compared to 47.4% of women, and they tend to be younger: 30.7% of female members are over 65 compared to 35.6% of male members of SMSFs.
* However, high balance accounts are more likely to be held by men than women with men over 65 with account balances in excess of $100,000 holding 15.5% of total superannuation holdings, compared to women over 65 holding 9.7% of total superannuation holdings. (Clare,2017).
* ATO data shows that in the 2015-16 year there were 146,516 superannuation accounts in retirement phase that had a balance in excess of $1m, and of these accounts 59% were held by males, and 40% by females.
* The ATO data further shows that of all superannuation accounts that are not yet in retirement phase and are receiving contributions, 46% of taxpayers over age 65 with a taxable income of less than $80,000 are women (ATO, 2018 Table 26).
* Women hold lower superannuation balances overall than men in both retirement and accumulation phase.
* The policy will also reduce the effectiveness of discretionary family trusts as an income splitting mechanism. Currently the franking credits can be streamed through the trust to a low income family member who is eligible to claim a refund of the surplus franking credit. There is some evidence that women receive substantial amounts of refundable franking credits though family trust distributions.

# NFAW’s position

* The proposal to limit franking credits to the amount of income tax payable will remove the mechanism in the taxation system under which shareholders who receive untaxed income from superannuation are also able to claim a refund of surplus franking credits but does not address the need for a more fundamental review of taxes on withdrawals from superannuation.
* The exclusion of persons in receipt of pensions and allowances from the federal government limits the effect of the changes on persons earning less than the upper level of the means test: currently $2,004 per fortnight for a single person and $3,066 for a couple living together.
* The pensions exclusion should be extended to people receiving income from the investment of compensation payments or special disability trusts.
* As women hold lower balances in SMSFs and have lower shareholding balances, the policy will not have a detrimental effect relative to men.
* The tax saving should be redirected to support health and aged care services. As older women are heavier users of health and aged care services, the allocation of additional funding to those areas of expenditure will benefit women.
* Transition arrangements should be implemented in respect of taxpayers who have established retirement income streams on the basis of the refund of franking credits.

# Party positions

## ALP

* The ALP has proposed changes to the franking credit system that allow a cash refund of franking credits that exceed a shareholders tax liability in respect of individuals and superannuation funds.
* The proposal was amended to not apply to people in receipt of a Commonwealth pension or allowance. As at September 2018 55% of pension recipients were women.

# Background

* Currently a person who receives franking credits in excess of the tax payable on their total income is able to claim a refund of the excess. Limiting franking credits to the amount of tax payable has been costed as raising $5,197 million over the forward estimates period to 2020-21 (PBO, 2018a).
* The franking credit system was introduced in 1987 to remove double taxation on company profits. Prior to the introduction of franking credits (the classical system), the company paid corporate tax on its earnings while the shareholder also paid personal income tax on the dividend. Based on current tax rates, a dollar earned by a company and distributed to a shareholder would carry an effective tax rate of up to 61.5% under the classical system:
  + Shareholder tax rate: Max 45% Low 19%
  + Company earnings $100.00 $100.00
  + Company tax paid $ 30.00 $ 30.00
  + Dividend paid out $ 70.00 $ 70.00
  + Shareholder tax on dividend $31.50 $ 13.30
  + Net dividend after tax $38.50 $ 56.70
* The franking system was introduced to reduce this double taxation. Under the franking system a resident shareholder pays tax on dividends at their marginal tax rate and receives a credit for the tax paid by the company. Therefore a person who is on a marginal tax rate higher than the corporate rate pays additional tax, while a person on a lower tax rate receives a credit that is higher than the tax they would pay on the dividend:
  + Shareholder tax rate: Max 45% Low 19%
  + Company earnings $100.00 $100.00
  + Company tax paid $ 30.00 $ 30.00
  + Dividend paid out $ 70.00 $ 70.00
  + Tax on gross dividend $100 at 19% $45.00 $ 19.00
  + Company tax paid $ 30.00 $ 30.00
  + Outcome: additional tax due $15.00 surplus credit: $ 11.00
* The current debate is around the appropriate treatment of surplus amounts.
* The philosophy underpinning the introduction of the franking system was the removal of double taxation; therefore the surplus could be used to offset tax payable on other income but was not refundable if tax was not payable.
* In 2001 the law was amended to permit the surplus to be refunded as a cash amount where a person does not have tax payable on other income. This approach treats the corporate tax as a withholding tax: ie the company is prepaying tax which is credited to the individuals.
* Australia and New Zealand are the last countries in the OECD to apply a full system of franking credits (Henry et al, 2010, 191), and the NZ system does not allow a refund of surplus franking credits, instead allowing the surplus to be carried forward to offset tax payable in later years (IRD, 2018). Alternative methods of limiting double taxation on company profits include tax exemptions on dividends; reduced tax rates on dividends received and allowing the company to exclude dividends from taxable income (dividend deductions) (Henry et al, 2010, 187). These methods do not result in a cash refund to the shareholder.
* The value of these refunds has increased significantly from $1.9bn in 2006 to $5.9bn in 2014-15. The two types of investors most likely to receive refunds of franking credit offsets in 2014-15 were individuals ($2.3bn) and SMSFs ($2.6bn) (Treasury, 2018).
* The significance of the increase in franking surplus refunds from 2006 is that superannuation withdrawals were made fully tax free for people over the age of 60 from 2007. As the tax payable by people drawing superannuation income streams was reduced to zero, the value used to offset other tax liabilities was reduced leaving a higher surplus of franking credits for refund (Treasury, 2018).
* There are structural concerns in the taxation of superannuation that warrant a reform package that is wider than the removal of franking credits. NFAW has previously recommended that superannuation should be taxed at marginal tax rates with a credit for the tax paid by the superannuation fund (NFAW, 2015).
* The distributional effects of the change need to be considered on the basis of the distribution of wealth as well as the distribution of income. More than 85% of shares held by individuals are held by individuals in the top 20% of households by wealth (more than $1,291,000); and more than 80% of excess franking credits claimed by Self-Managed Superannuation Funds (SMSFs) was refunded to funds with account balances in the top 30% of balances (over $1,044,622) (PBO, 2018).
* As superannuation withdrawals are exempt from taxation, a person with a high balance in superannuation, including shares, may have a low taxable income. 68% of surplus franking credit refunds are attributable to tax free superannuation (Treasury, 2018). For example, a person with $1.6m in a superannuation fund in retirement phase could withdraw 8.75%, or $140,000 pa which would be tax exempt income. This person would appear in the tax data as a low-income taxpayer. If 50% of that income was from franked dividends, they would be entitled to a tax refund of the surplus of $30,000 As a comparison:
  + Superannuation income Taxable Exempt
  + Dividend 140,000 140,000 0
  + Grossed up 30,000 0
  + Taxable income 170,000 0
  + Tax payable (2018-19 rates) 53,797 0
  + Franking offset 30,000 30,000
  + Net tax payable/refundable 23,797 -30,000
  + Average tax rate (tax payable/income received) 17% 0%
  + As a point of comparison, a person earning $140,000 from non-dividend earnings would pay an average tax rate of 38%.
* Data (Media Release 19 March 2019) has been circulated stating that more women than men receive franking credit refunds at all ages. This data does not show the amount of the refunds. Further, the media release states that the average individual with shares will lose almost $2,300 from franking credits. The PBO analysis states that the amount is $1,800 (PBO, 2019, Table C5).
* Surplus Franking credits can also be claimed where distributed through a family trust or partnership. The practice of streaming franking credits through a family trust is a form of income splitting that is permitted under the income tax law.
* NFAW has analysed the data available in the Tax Statistics (ATO, 2019, Table 13) of taxpayers who receive a tax refund and has identified franking credits claimed directly or through a family trust or partnership.

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Age | <18 | 18-24 | 25-29 | 30-34 | 35-39 | 40-44 | 45-49 | 50-54 | 55-59 | 60-64 | 65-69 | 70-74 | 75+ |
| Females |  |  |  |  |  |  |  |  |  |  |  |  |  |
| *Average Franking Credit: Direct* | 281 | 465 | 386 | 571 | 786 | 1076 | 1349 | 1617 | 1737 | 2139 | 2319 | 2984 | 4690 |
| *Average Share of Franking Credit: Through P/S or Trust* | 3115 | 6377 | 4365 | 4321 | 5590 | 6015 | 5803 | 4808 | 5626 | 5013 | 4803 | 3922 | 2879 |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Males |  |  |  |  |  |  |  |  |  |  |  |  |  |
| *Average Franking Credit: Direct* | 327 | 435 | 523 | 834 | 1130 | 1498 | 2054 | 2251 | 2395 | 2569 | 2723 | 2969 | 4593 |
| *Average Share of Franking Credit: Through P/S or Trust* | 3053 | 7088 | 3233 | 3136 | 3805 | 4992 | 5994 | 5248 | 6162 | 5124 | 5564 | 5481 | 3436 |

* This analysis shows that the average value of franking credits received through family trusts and partnerships exceeds direct franking credit claims in all age groups under age 75; and that women receive higher distributions of franking credits than men from partnerships and family trusts.
* The average direct franking credit claimed by males is consistently higher than that claimed by women, except in the 18-24 and 75 and over age groups.
* However the data show that taxpayers over 75 years of age are more likely to claim direct franking credits. This cohort was less likely to have a significant superannuation balance at retirement as the mandatory scheme was introduced when they were over 50; and many would now find it difficult to restructure their financial affairs. Transitional measures should be introduced to support this cohort. Suggestions include:
  + a phasing out mechanism to allow an orderly restructure of their portfolio;
  + an age based exemption from the policy; or
  + an exemption that takes account of whether the taxpayer also receives exempt superannuation income.

**Authorised by Kate Gunn, Sydney.**

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ALP Policy Document

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