Association of Independent Retirees (A.I.R.) Limited
ACN 102 164 385

Australia's Future Tax System

Submission - Dividend Imputation

April 2009

23 April 2009

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Dr Henry

Submission on Dividend Imputation

Many A.I.R. members have written to me to say that they have read or been advised that the Panel reviewing Australia's Future Tax System is addressing the question of whether there should be change to Dividend Imputation for share dividends. What with the impact on retiree incomes and investments of the current economic crisis, there is fear in the hearts of many self-funded retirees regarding the additional negative effects on their incomes and assets that would result from withdrawing or reducing Dividend Imputation.

The attached submission addresses the likely impacts on self-funded retirees of any change to the Dividend Imputation system.

It is submitted by A.I.R. in the sincere hope that the Panel and the Government will recognise the importance of not further reducing the independent incomes and investments of self-funded retirees in the context of maintaining their independence and minimising their need to rely on government welfare throughout their remaining retirement years.

The points outlined in this Submission have been developed in consultation with A.I.R. members across all States and Territories. They are intended to assist the Review Panel in reviewing Australia's Future Tax System.

I hope that this Submission will be accepted as positive and supportive of Government policy objectives. Should you require any further information, please contact:

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Yours sincerely

Theresa Kot
National President

Executive Summary

The Association of Independent Retirees (A.I.R.) Limited is the peak body representing the interests of retirees who are wholly or partly self-funded in retirement. A.I.R.'s members include full self-funded retirees, part-pensioners, and superannuants.

Founded in 1990, A.I.R. is a not-for-profit, non-political, volunteer organisation that is focused on matters affecting the standard of living, health and welfare of retired and partly-retired people. As well as carrying out research and gathering information that will assist its members in maximising their life opportunities, A.I.R. is committed to educating the wider community (including political parties at all levels of Government) regarding the views and concerns of self-funded retirees.

This submission reflects the views of partly and fully self funded retirees who have experience in managing their affairs during retirement. As such they have a clear understanding of the issues that affect their capacity to live a fulfilling retirement, and can provide pragmatic and realistic inputs into the Review on issues such as this.

Dividend Imputation is very important to self-funded retirees as many are shareholders with significant equity investments in Australian corporations. In many instances the investment strategies that they employed up to the time of their retirement, as well as subsequently, were heavily influenced by the availability of Dividend Imputation. Any direct or indirect increase in personal taxation that arises from a change to that system will have a significant impact on the ability of self-funded retirees to maintain their lifestyles, to maximise the use of their investment, and to minimise their need for government welfare support throughout their remaining retirement years.

If, however, it is deemed by the Review Panel that there is need for a change to the Dividend Imputation system, it is vital that extensive consultation be undertaken with all stakeholders, especially self-funded retiree shareholders, regarding the implications of such change.

Recommendations

1. That no change be made to the current Dividend Imputation system.
2. If Recommendation 1 is not accepted, and a change is proposed to the current Dividend Imputation system, that the opportunity for extensive discussion of any alternative model or models be provided to all stakeholders, especially self-funded retiree shareholders.

Submission

Australia is an egalitarian society. It has a social structure with a spectrum of incomes and standards of living. People expect that their standards of living will be able to be maintained in retirement. They do not accept a welfare model that forces them onto a basic, or indeed 'comfortable'[1], common standard of living for all retirees.

There is dysfunctional thinking in government between its need to reduce the demands of current and future retirees on the government-funded welfare system (by forcing/encouraging people to become more self supporting through superannuation and private savings) and its pressure to extract tax from these same superannuation and private savings, before and during retirement.

Dividend Imputation is designed to avoid double taxation on dividends. Corporations obtain franking credits for company tax paid (notionally at 30 percent) on profits that they generate. To the extent that the corporations pay dividends from these profits, they can pass on the tax paid as Franking Credits to their shareholders. Where the shareholder is an individual the government receives its tax on the shareholder's share of the profits generated by the company as personal tax.

It can be argued that there are some negative aspects on corporations of the present Dividend Imputation system and that change should be brought about to benefit corporations. However, the impact of any such change on individual shareholders is an equally important factor that must be considered. There is also an argument from a Treasury point of view that tax foregone at the company tax rate of 30 percent and collected as personal tax at marginal tax rates less than 30 percent distorts the overall tax take. However, the opposite is true for self-funded retirees as a group as demonstrated below

Dividend Imputation has a significant impact on the income generated from equity investments that support the living requirements of retirees, whether through superannuation or private investment. Any change that increases the Government's tax take from retiree incomes, whether directly or indirectly through a change to the Dividend Imputation system, will have the detrimental effect of reducing a self-funded retiree's annual income as well as reducing the asset base from which future income (including pensions) is generated.

Reducing a retiree's annual income from superannuation or private investment has the effect of also reducing the discretionary spending available to maintain standards of living and to maintain an active and healthy lifestyle. This, in turn, leads to higher health care system costs, increased demand on the Age Pension and public welfare system, reduced volunteer activity (which is fundamental to maintaining Australia's community support system), and greater personal worry and dissatisfaction through being unable to meet retirement standards that have been worked and saved for over the retiree's working life.

Reducing the retiree's asset base by, for example, reducing Franking Credits, will have the significant and compounding effect of forcing self-funded retirees onto the Age Pension system at an earlier age, thus increasing the Government's welfare cost on future budgets.

[1] A number of Surveys, including the Westpac Survey, quote a range of incomes for achieving so-called comfortable standards of living. These take no account of the spectrum of living standard expectations in the Australian community.

Surely, it must be far more costly for Government to force retirees into seeking the Age Pension and other welfare provisions at an earlier age than it is to construct taxation and other policies that encourage the maintenance of retirement investment assets, whether they are held inside or outside superannuation!

The retirement investment assets held in superannuation and held privately (currently trillions of dollars and growing) is one of the most significant sectors of investment in Australia. Any change to the Dividend Imputation system that increases the Government's tax at the retiree's expense will have a significant effect on stockmarket investments (currently going through their most traumatic period since the Great Depression), and will cause many current and future retirees to further question the value of saving for retirement as compared with relying on the Government's welfare system to sustain them in their later years.

The introduction of Dividend Imputation in 1987 as a tax rebate led to five years of dissatisfaction before it was changed to the current tax credit system. If previous mistakes are not to be repeated, any proposed change must take into account any resultant complexity and unintended effects on the various stakeholders. In particular, any change to the Dividend Imputation system that reduces the Franking Credit paid to an individual shareholder without any corresponding (including non-financial) compensation, will be of great concern to retiree shareholders.

Retirees, through their superannuation and private savings, represent a high percentage of the shareholders who invest in Australian corporations. Many self-funded retirees, especially older persons, have been forced to accumulate their retirement assets outside superannuation. More recent retirees have been more fortunate and have been able to access superannuation through Self Managed Superannuation Funds (SMSFs). In either case, they have developed investment strategies based on the present taxation regime, including Dividend Imputation. For example, many self-funded retirees decided to invest in equities rather than in 'safer' fixed-interest accounts or property because of the availability of Franking Credits; others decided that they would only invest in companies that passed on full Franking Credits to their shareholders. Any change to the Dividend Imputation system that reduces retiree incomes will cause many of these self-funded retirees to consider changing their investment strategies. However, this could be difficult because most retirees are long term holders of equities and consequently, would have difficulty in changing their investments because of capital gains tax issues (It would be even more difficult to change from one form of investment to another, e.g., changing from equities into directly-owned and managed property).

One argument commonly expressed in favour of removing Dividend Imputation is that corporate tax rates could be reduced leading to an increase in share prices. For self-funded retirees without superannuation, removal of Franking Credits offset to some extent by increased share prices would mean that investments would have to be sold to derive the benefit, consequently incurring capital gains tax, whereas the present Imputation Credit system allows the benefit to be received directly as income available for living purposes. For self-funded retirees with assets in SMSFs, the benefit of a higher share price could only be obtained by selling the asset and using the income to pay pensions. Receiving income in the form of Franking Credits is a far superior method for these groups of self-funded retirees to manage their assets.

The Dividend Imputation system allows self-funded retirees without superannuation or with assets in SMSFs to manage their investment affairs in such a way that they (or their SMSF) obtain a refund at the end of a Financial Year rather than paying PAYG tax throughout the year. They find that this arrangement gives them added flexibility and provides a lump sum cash return that assists in managing their investments and incomes. Such management attitudes and processes are not trivial to individual retirees, particularly older ones.

In the 2005/2006 Financial Year 30% of all retirees[2] paying income tax (552,000 persons) paid income tax at the 30 percent marginal tax rate; this is broadly the same as the company tax rate and neutral with respect to tax revenue foregone by the Government from Franking Credits. Over half of all retirees paid income tax at less than the 30 percent marginal tax rate; in total these payments amounted to 12% of all income taxes paid by persons 65 years of age and over ($7.1 billion). Only 10% of retirees paid income tax at greater than the 30 percent marginal tax rate. However, in total these payments amounted to 62% of all income tax paid by persons 65 years of age and over. Hence, for retirees, the Government logically receives more income from Dividend Imputation than it loses from Imputation of company tax on the dividends.

From 1 July 2007, Government policy changed such that retirees with taxed superannuation funds pay no tax on pensions drawn from, or earnings made from, fund assets. There is no justification for trying to claw back some of this beneficial policy by changing the Dividend Imputation system to reduce fund earnings.

Recommendations

1. That no change be made to the current Dividend Imputation system.
2. If Recommendation 1 is not accepted, and a change is proposed to the current Dividend Imputation system, that the opportunity for extensive discussion of any alternative model or models be provided to all stakeholders, especially self-funded retiree shareholders.

[2] A.I.R. Response to the Tax Review Consultative Paper, Appendix 1, Feb 2009.