Australian Foundation
INVESTMENT COMPANY

Australian Foundation Investment
Company Limited
ABN 56 004 147 120

Level 21, 101 Collins Street
Melbourne Victoria 3000

GPO Box 2114
Melbourne Victoria 3001

Telephone (03) 9650 9911
Facsimile (03) 9650 9100
Email invest@afi.com.au
Website www.afi.com.au

30 April 2009

AFTS Secretariat
The Treasury,
Langton Crescent,
PARKES
ACT 2600

Dear Sir or Madam,

SUBMISSION WITH REGARDS TO "AUSTRALIA'S FUTURE TAX SYSTEM – CONSULTATION PAPER"

In summary, Australian Foundation Investment Company ("AFIC") calls for the following :

1. Retain the dividend imputation system in full, thus continuing the equitable principle of not taxing company income twice.

2. Maintain the 50% capital gains discount for tax to continue to encourage investors to invest in Australian businesses, and the ability of Listed Investment Companies to pass on this discount to their shareholders via an income-tax deduction.

3. Reintroduction of indexation allowance for capital gains to maintain the real value of capital.

Treasury has called for written submissions from the Australian community with regards to the Consultation Paper for Australia's Future Tax System.

We are writing on behalf of Australian Foundation Investment Company Limited Australia's largest Listed Investment Company, representing almost 90,000 shareholders, primarily domestic and retail. Shareholders invest with us not only for a comparatively inexpensive way of accessing capital growth over the medium to long-term but also to access fully-franked dividends that the Company seeks to increase faster than the rate of inflation. Some of the points made in this submission will be re-iterating points made in the previous submission dated 12 September 2008 with regards to the "Architecture of Australia's Tax and Transfer System."

The review of Australia's future tax system provides a unique opportunity to look at ways to encourage more Australians to invest in Australian companies and increasingly to become self-funded retirees.

In response to some of the specific questions that are raised in the consultation paper:

Q1.1 In considering the community's aspirations for the type of society that Australia should become over the next two decades and beyond, which key features should inform or drive the future design of the Australian tax-transfer system?

We believe there are significant benefits for the community and society as a whole in widening the participation of ordinary Australians in investment in Australian businesses. A key component of this is that investors are not penalised by investing in companies and over the medium to long term receive attractive income and capital growth commensurate with the risks taken. The existing tax framework of dividend imputation, capital gains discounts etc. should be at least retained and possibly widened to include the ability to maintain one's capital in real terms by reintroducing the indexation allowance for capital gains.

In view of Australia's aging population and the resultant increased demands on the public purse, Australians need to continue to be incentivised through the tax-transfer system to become increasingly self-funded through retirement. The zero tax rate on pensions paid by superannuation funds and on the funds themselves when they enter the pension-paying phase and the ability to reclaim tax paid by companies on franked dividends are vital parts of this. Serious consideration needs to be given to extending the taxation benefits of investing through superannuation, including reducing the tax rate on the funds during accumulation phase and increasing tax deductions for contributions into superannuation funds.

Q3.2 Does Australia's tax system penalise (or favour) the returns to savings relative to other activities and should this lead to changes in the structure of taxes and means tests?

Q3.3 Does Australia's tax-transfer system appropriately deal with property and wealth, or should new approaches be introduced? What, if any, implications would any changes have for the taxation (or means testing) of capital income flowing from property or wealth?

As noted above, incentives for saving and thus for investors to provide business and financial institutions with the necessary funding are extremely important. Currently, the system that eliminates double taxation through dividend imputation and attracts longer–term investors through the capital gains tax discount is in our view amongst the most advanced and equitable in the world, but there is still some room for improvement.

Anything that would discourage investors, from any income group, from investing in Australian businesses would ultimately be extremely detrimental to the Australian economy.

It is important to note that since the onset of the global financial crisis the Australian equity market has been one of the very few markets in the world that has been able to conduct successful capital raisings as companies seek to recapitalise their balance sheets. The attractiveness for both Australian retail and superannuation fund investors of investing in Australian equities is in large part due to the dividend imputation system as well as the discount on capital gains.

Q5.4 What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

As noted above, it is very important to ensure that the tax framework is provided to enable people to work towards the target of becoming self-funded in retirement. The current tax arrangements promote this, and should certainly not be abolished – in fact, they should be regarded as minimum levels.

It also needs to be recognised that many people seek to save and/or invest through mechanisms other than superannuation. This is a necessary component of funding the Australian economy. Consideration should be given to extending some of the benefits of the superannuation regime towards other investments made in Australian businesses such as reduced taxation rates on such investments.

It is worth reinforcing the view held by the Company, on behalf of its shareholders, that the current dividend imputation system is an integral part of this, and should be maintained (albeit with some improvements such as allowing a market to develop for companies to buy and sell excess franking credits).

It is often suggested that a focus of attention should be to make changes that enable shareholders' wealth to be increased by increasing the value of the companies in which they invest. Whilst this is important, it overlooks a key point, which is that for many retail shareholders it is far more preferable to be able to derive income from dividends and distributions than to have to sell their investments in order to be able to realise value. Having to sell, even in a rising market, reduces their capacity to derive on-going income from their investments. If an objective of taxation policy is to encourage retail investors, then attention must be directed towards policies that enhance their ability to derive on-going income – such as dividend imputation.

Q6.1 Can the tax system be structured to better attract investment to Australia in a way that increases national income, and if so how? For any given revenue outcome, what are the relative merits of broader base/lower rate (comprehensive income tax) or narrower base/higher rate (a narrow income tax or an expenditure tax) approaches?

Q6.2 What changes, if any, to the tax system would improve the ability of Australian companies to operate internationally orientated businesses? How should the tax treatment of companies and shareholders be integrated in an open economy?

The principle that Australian investors should not suffer double taxation is sound, and should not be compromised. Retail investors, including participants in superannuation funds, benefit greatly from this and the franking regime is an inducement to invest in the Australian economy as opposed to investing directly off-shore, which would become a more attractive option should the franking regime be abolished or curtailed. Even countries that do not have a full dividend imputation regime have recognised the inequities of double taxation, as noted in the original 'Architecture of Australia's Tax and Transfer System'. It enables the tax treatment of companies and their owners (the shareholders) to be integrated such that profits in the hands of the owners are subject to tax only at the shareholders highest marginal rate.

In terms of encouraging investment as a whole in Australian companies, it should be noted that asset allocators will frequently note that investment funds should only carry, for example, 2% of their holdings in Australian equities as Australia only represents 2% of the world market but will then lay an overlay on this, recommending to domestic funds that this percentage be increased due to the benefits of the imputation franking credits. Should the imputation credit be lowered or removed, it is likely that the asset allocation of domestic funds will reduce and there is no certainty that off-shore funds would be able or willing to step into their place.

With regards to attracting investment to Australia, the dividend imputation system is sometimes held up as a hindrance, citing the possibility that lower corporate tax rates would bolster overseas investments. The dividend imputation system already provides one benefit to overseas investors in that there is no withholding tax levied on fully franked dividends paid to them. Furthermore, we do not believe that there is evidence of overseas investors avoiding Australia as an attractive place for investment because of the dividend imputation system.

As noted above, it is important to reinforce the point that in our experience retail shareholders require on-going income from their investments, not just the accumulation of wealth that occurs when incentives are given to cut dividend pay-outs and enhance re-investment of profits.

Q6.4 What principal goals should inform the taxation of capital gains in Australia and what, if any, changes should be made to capital gains as a result?

In our view the regime for taxing capital gains should include the following goals:

a) To encourage investment in Australian businesses

b) To encourage savings in both superannuation and in other vehicles from the Australian public to reduce future dependency on government support.

c) To allow investors to maintain the real value of their capital.

As a minimum, the CGT 50% discount should be maintained.

In addition, the non-superannuation savings regime should be reviewed to see if taxation benefits currently enjoyed by superannuation funds can to some extent be transferred to other investment vehicles.

In uncertain times and particularly when inflation is high investors are looking to maintain the real value of their capital. We believe that the indexation of capital gains to reflect the rate of inflation is an important way in which investors are not penalised. It is important that tax is not levied on gains that merely reflect the impact of inflation and have the effect of reducing the real value of capital.

Q6.5 Should the tax system be restructured to deliver a more neutral tax treatment for the different forms of return on household savings and investments, and if so, how?

It is mutually beneficial for Australian companies and investors that they be encouraged to invest for the long term through equity. This has been illustrated recently by the difficulties caused for highly leveraged companies and the broader economy when debt funding has been unavailable or withdrawn.

It is also recognised that equity investments in a company carry a greater degree of risk than placing funds on deposit, and this should continue to be recognised through the tax system through the differential taxation treatment of dividend income and capital gains, as noted above.

We would be very pleased to expand on any of the above points as the representative of a large number of retail shareholders in Australian businesses at your convenience.

Yours sincerely

Ross Barker	*Andrew Porter*
Managing Director	Chief Financial Officer