TO: Dr Ken Henry,
Chair
The Australia's Future Tax System Review Panel.

Dear Dr Henry.

A -0 Consideration is to be given to the question of whether to retain the status quo as it relates to "Franking Credits" or, alternatives such as reducing their value or, their complete abolition.

I want to put the case for: FRANKING CREDITS TO BE RETAINED IN ANY FUTURE TAX SYSTEM, WITH AN UNCHANGED STATUS QUO VALUE, AS EXISTS UNDER THE CURRENT TAX SYSTEM.

My interest stems from the fact that my wife and I are Trustees of our self managed super fund (SMSF), which we set up in **[removed for privacy reasons]**. My wife is **[removed for privacy reasons]** years of age and I am **[removed for privacy reasons]** years of age. We fund our existence from our yearly withdrawals of our pensions from our fund. We have been investors for many years and now, with the current financial crises, we have experienced all the economic cycles bar the 1930's "big one". So, we are "seasoned" investors. I set out my arguments as follows:

1-0 In all my years of investing I believe that the (Paul Keating) introduction of the Imputation Credit attaching to Franked Dividends, was a catalyst for the "mum/dad" investors to become interested in the sharemarket. That event coupled with legislated superannuation has spawned the growth of the superannuation industry and witnessed Australians become amongst the largest number of investors in the world. The consequences have been that the mums and dads have never been wealthier (some might dispute that at this particular time of financial crises!). The size of our capital markets have exploded and Australia, as a nation has benefitted enormously. Australia, with an ageing population, has experienced many more citizens taking responsibility for their own financial future in their old age.

2-0 Franked dividends are the backbone of Australian sharemarket investing. It would be the wrong strategy for the government to change the franked dividend policy as the sharemarket will loose its appeal to a large number of investors and particularly members of SMSFs which contain a sizable proportion of the ownership of Australian equities. The value of franking credits to Australian investors has been considerable as studies show that franked dividends added 18% to total shareholder returns in less than a decade. Of course this is just the average benefit. Investors who target high yielding, fully franked dividends would be expected to receive benefits above this level. Ref. Scott Francis, James Kirby, Eureka report 18/3/09.

3-0 Some arguments that have been mounted in the debate so far are not ignored. Research consultancy Lateral Economics has estimated that removing the dividend imputation system would free up $20 billion a year and that a reduction in government costs might underpin a cut in the corporate tax rate from 30% to 19%, no doubt improving headline profitability for companies, especially those that pay high effective tax rates. No doubt there are logical arguments for reviewing many aspects of the tax system including company tax. However, retiree investors such as I am would prefer to get their money (their tax credits) upfront rather than waiting to see if a reform of the tax system would ultimately improve things. My experience is that in so many cases the shareholder is of minor consideration. A recent case in point is the actions of Rio in heading off the BHP takeover. The management group and directors were more concerned about their own jobs that they splurged on a buying spree, borrowed heavily. We know that the shareholders and AUSTRALIA'S interest would have been better served by joining together! So many other cases exist such as AIG spurning the offer from QBE. The recent Telstra fiasco, which has cost shareholders dearly. The risk to shareholders of getting increased dividends because the tax rate has decreased, is about 20% but unreliable at that. With the population ageing it is imperative that companies continue to pay out a high proportion of their profits as dividends. Retirees need cash to live on!

4-0 The Boston Consulting Group state that the dividend imputation system has been a factor in the ability of Australia's listed companies to create consistently higher shareholder returns with less volatility than rival international companies. I agree that shareholders, and particularly those moving towards retirement, are most attracted to franked dividends and companies paying such dividends are on investors' radar, with the result that the shares attract a premium price. The salary packages of the executive management group of many companies provide for performance criteria relating to an increasing share price and hence franked dividends motivate the executive team to pay increasing dividends which ratchet up the share price. Australian shareholders receiving such dividends are loyal and tend to stick with the company which reduces the volatility.

5-0 It is said that Australia is one of only two countries that have franked dividends. I say "So what" our system has a need to be superior because it must, by design, encourage Australians to invest and stay invested, to assist the development of our large land base, to reduce the quantum of reliance on overseas capital (which is inherent in our thirst for development capital) and to satisfy the needs of an ageing population for investment returns to live on. Australia has tapped a local source of capital that, in the past would have come from overseas and hence the outflow for repayments has been reduced. Other countries could learn from our experience.

6-0 Importantly for older Australians, by investing locally in fully franked shares they reduce their risk profile, due to greater stability in the share price and the absence of currency fluctuations on dividend payments. Home grown capital is likely to be "sticky" and not prone to "packing the bags and going home" at the first sign of trouble! The accumulation of wealth is required before substantial investment can take place. Home grown capital has a lot to recommend it and should be encouraged as "self help". An advantage of a company paying out a large proportion of its profit as dividends is that an element of capital rationing is introduced to the company. This can instill a spending discipline of "frugality" within the company and has a propensity to keep the entity more "lean and mean". An absence of lazy cash holdings goes some way to preventing fat, overblown and inefficient entities.

7-0 The claim that franking credits are of no benefit to foreign investors and their cutting or scrapping, in exchange for a cut to the company tax rate, could be attractive to foreign investors. This sounds plausible but on examination is open to a few questions such as: How much extra investment is likely to be made as a result of such action? Will this extra investment be in addition to existing investment or, will it merely replace local investment? The claim is particularly shallow when it is considered that the Australian dollar is about the largest traded currency in the world for a number of reasons but substantially to do with the carry trade. Foreign investors can borrow in their own countries at very low interest rates, eg., Japan, invest in Australian shares paying high dividends (compared to those in their own country) and make a lot of money. This has been the case for a very long time. However, with the financial crises, large amounts of capital have been withdrawn from Australian and assisted destabilise the Australian market which is not a favorable attribute of foreign investment. Modeling carried out this month on the effects of lower franking credits shows that an Australian resident would be worse off under a scenario where the company tax rate was reduced in a tradeoff for lower franking levels Ref. Scott Francis Eurekareport, March 09.

8-0 Overseas companies do not generally pay high dividends. The corporate cultures are opposed to parting with the cash. The thinking is along the lines that if you return a large proportion of profits to shareholders, you admit that management has run out of ideas on how to use the proceeds to grow the company. This of course has led to many disastrous merges and acquisitions. See point 3-0 above for some local examples. The Australian advantage is that franked dividends encourage the payment of higher dividends. Without franked dividends to satisfy foreign investors, the culture is very much likely to change to reflect the overseas model of low dividends which will be less attractive and tax-ineffective dividends will be cut and reserved for capital gains which would be concessionally taxed but of no use to retirees. What's more, these moves would almost certainly take place against a background of reducing dividend payouts. This is likely to see an exit of retirees of SMSF, from the stockmarket to less riskier lower yielding investments. Perhaps this will mean that retirees' capital will run out faster, given the longer lives that people are living to, with the consequences of our ageing population living in poverty!

9-0 Under no circumstances should franking credits be cut to disadvantage Australian investors under the delusion that overseas investment in Australia will increase because of the elimination of franking credits. It beggars belief that it would even be considered given scant evidence of any really significant financial advantage benefiting Australian residents. The Australian economy is already the most open in the world. Other countries pay lip service to "an open economy" but when the chips are down their citizens get first suck of the pineapple and I don't disagree with that!

10-0 the inclusion of franked dividend paying shares weigh heavily in stock selection of the investment portfolios of retirees of SMSF'S .removal of franking credits will mean a significant reduction in incomes of these people. In my own case imputation credits comprised 22.3% of net income for the 07/08 financial year. These same people will suffer significant capital losses as the values of these shares will fall significantly. Australian "Sovereign Risk" for Australian investors has increased significantly under the Rudd Labor Government which is of the same political persuasion as the Hawke/Keating Government that introduced the system. Sadly, many will be joining the social security queue which doesn't seem cost effective.

B-0 The second question being considered is that of retirees being allowed unfetted access to their super funds to withdraw, so called, lump sums. My submission follows:

The first thing to settle is that we must be referring to an amount in excess of the minimum yearly withdrawal required to be taken each year. The minimum can be withdrawn as a lump sum each year, the same as an amount over and above the minimum. The withdrawal of extra money, above the minimum, would normally be for emergences and adds flexibility to ensure that if the extra money is required for say a life saving operation in Switzerland then you can feel comfortable that you can get at your money! Without this element of flexibility, not many will fall for locking away their money. Now this is a very vexed question because when decisions were made to establish a SMSF all the rules and legislation were considered and then the decision was made based on all the known information. To now start to consider changing the rules retrospectively is just not on and we will all call foul. It is akin to cheating and disadvantaging another. Just cheap skate! To have government tell me I can't get my money back when I want it is robbery!! If the law is to be changed then I should be given the option to withdraw funds within a timeframe before legislated change takes effect.

Retrospective decisions are recognised for what they are, like backdating a contract to disadvantage the other party, not up front and open. THIS CAN NOT BE SERIOUSLY CONTEMPLATED!

We are: Janet and Peter Ellis