

Australia's future tax system Consultation paper

Dividend Imputation System

Background

Chapter 6 of the Consultation paper is headed "Taxing Business and Investment". The chapter deals with various aspects of the taxation of businesses and investments. One matter relevant to this area is the current dividend imputation system.

The current dividend imputation system was introduced in 1987 and brought an end to the double taxation of company profits. The current system provides shareholders with a credit for the amount of company tax paid on company profits which are distributed to shareholders as dividends. For shareholders who are on a tax rate lower than the company tax rate of 30%, the excess credits are able to be used to reduce other income tax liabilities the shareholders may have, and in some cases are refundable to shareholders. The system is highly effective in ensuring company profits are not subject to double taxation.

In addition, the current dividend imputation system provides many other benefits to shareholders and the broader Australian community.

Support for the current dividend imputation system

We are of the view that the current dividend imputation system provides a fair outcome for all shareholders and is a major reason why many Australians invest in Australian companies either directly or through their superannuation funds. There are many arguments in favour of retaining the current dividend imputation system. Some of the main reasons are:

- 1. Removal of double taxation** - Without the dividend imputation system, company profits will be subject to double taxation. That is, the company profits will be taxed in the hands of the company and again in the hands of the shareholders. This will result in the total tax collected by the Government on company profits and dividends to increase from the current level thereby reducing the net return to shareholders. The example in the attached appendix A highlights this point as it applies to superannuation funds.
- 2. Reliance by shareholders on income stream from dividends** - Many shareholders rely on the dividend income from their investments. This is especially the case for self funded retirees and superannuation funds providing pensions to members. The removal of the current dividend imputation system will result in more tax being paid by the shareholders thereby reducing the income that these shareholders receive from their investments. This would severely reduce the attractiveness of investing in Australian companies.
- 3. Attraction of investing in super** - Australians are continually encouraged to invest in superannuation in order to provide for their retirement. In addition, there is much concern and discussion regarding the level of financial adequacy for retirees. Removing the dividend imputation system will have a negative impact on the financial adequacy of retirees and will be a disincentive for Australians to contribute more than the minimum into superannuation.
- 4. Operates as an anti-avoidance regime** - The current dividend imputation system has in effect operated as an anti-avoidance regime. This is because Australian companies have an incentive to pay income tax in Australia rather than off-shore in order to be able to pay fully franked dividends to their shareholders. Without the current dividend imputation regime, Australian companies could be encouraged to move taxation obligations off-shore.

5. Source of long term capital funding – It is argued that the current imputation system discriminates against foreign capital invested in Australia. Whilst it is true that the abolition of the imputation system along with a reduction in the company tax rate will benefit foreign investors, there is no certainty that it will attract more foreign capital. Major superannuation funds currently provide a significant source of long term capital funding for Australian companies. The removal of the dividend imputation regime could see a reduction in this source of long term capital as superannuation funds may look to invest more offshore. This could have a disastrous effect on the Australian stock market and financial system.

As mentioned in the Consultation paper, *“many submissions support retaining and enhancing the imputation system because it is well understood and liked by Australian investors. Such submissions say a compelling case for abolishing imputation has not been made”*. Not only has no compelling case been made for the abolition of imputation, we believe imputation plays a fundamental role in providing for the retirement of Australians. On this basis we support the current dividend imputation system.