SUBMISSION TO THE TAX REVIEW
Number 2 from Geoff Read

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[removed for privacy reasons]

FRANKING CREDITS

Summary
I support the retention of franking credits also known as dividend imputation credits.

1. The existing franking credit scheme is somewhat similar to the operation of the GST. In the case of the GST at each stage of the product creation process the input cost moves forward with its associated GST input credits before the product eventually reaches its ultimate consumer where the final GST is paid on all of the value created during the manufacturing and sales processes. All parties agree that this is a fair mechanism and no one argues that if we deleted input credits then we could just charge say 5% GST on the total output cost at each and every stage.

Franking credits are somewhat similar to the above although of course it is income rather than costs which are moving through different entities. In the present system if Company A makes a profit and pays tax, it remits part of the profit as a dividend to Company B with the associated franking credit, and then Company B makes a profit and pays tax and remits part of the profit to the individual shareholder with an associated franking credit. The final receiving shareholder then pays tax at his/her tax rate with the franking credits as an offsetting credit.

So I say it is very similar to the GST processes and equally as fair as the GST processes.

2. If franking credits were to be removed, then tax would be paid each and every time a dividend was received. This would result in tax being paid multiple times on the same income.

Consider this example, if franking credits did not exist. A large bank makes a profit, pays tax and then pays a dividend to one of its shareholders which in this case is a Listed Investment Company; the LIC pays tax and then pays a dividend to its individual shareholders. The result of this is that we have the large bank paying tax on the income, then the LIC pays tax on the same income, then the individual shareholder pays tax on the same income. So instead of being effectively taxed once as is the situation today, the income is taxed 3 times. Clearly the income could be taxed more times in the case of more complex structures.
I cannot see how this can be a desirable policy outcome from any perspective.

Tax Rates. It has been reported that the removal of franking credits would allow the corporate tax rate to be reduced to 20%.

I make two observations, when the corporate tax rate is very different to the individual tax rate then there is always a rush to incorporate oneself as a small business and this distorts the equity of the process for all individual taxpayers, and if a lower tax rate makes Australia more attractive to overseas capital then that capital has to be serviced by either dividends or interest and that in turn further worsens our balance of payments.

THE END Signed Geoff Read