Title: Imputated Credits impact more than just the transfer of a company's profits to its owners/shareholders.

I believe there are some valid points that support my opposition to any proposed removal of imputated credits as is being considered by the Henry Tax Review. These points include:

1. DOUBLE TAXATION IS UNFAIR AND UNIQUE TO DIVIDEND INCOME.

In relation to dividend imputation, the ATO website states "The tax paid by the company is allocated to shareholders by way of franking credits attached to the dividends they receive"[1].

At the heart of the subject of dividend imputation is the legal structure of a public company, and the relationship between the entities within that structure. Specifically, shareholders can lay claim to the ownership of the company due to their ownership of shares in the company. The elected board is the shareholder's employee and is employed to oversee the running of the company. They are employed to appoint and monitor the managers of the company who control the operation of a company and the use of the company's profits.

However, as shareholders are the legal owners of the company, they can lay claim to the ownership of the company profits which are merely in a state of transition whilst being controlled by the managers appointed by the board to run the company.

It is a common belief that that dividends as tax free. However, since dividends are essentially company profits distributed by the company managers, they are not "tax free" due to tax having already been paid on the company's earnings.

Consequently, my concern is that unless imputated credits are attached to the dividend that shareholders receive, dividend income will be taxed twice because shareholders must then pay tax on dividends that have already been taxed and I feel that this is unfair.

I have no problems with paying tax, as I feel it is my duty to contribute towards the cost of the many government services provided. If the government chose to remove dividend imputation, the resultant tax system would be inconsistent and hinder the development of the private sector, and thus dampen growth and employment. An excellent example is that tax will paid once on the profits of a private company, whereas if that company was to need investor capital to expand and become a public company then any profits it made would be taxed twice, once at the company tax rate and again at the personal tax rate of each shareholder.

However, in the current system, imputated credits ensure that the unfairness of double taxation is not imposed on Australian taxpayers by ensuring that dividends are not the only income that is taxed twice, as I can find no other income that is taxed twice.

2. A LOWER COMPANY TAX RATES DOES NOT GUARANTEE INCREASED INVESTMENT.

The argument has been made that replacing imputated credits with a lower company tax rate will attract greater overseas capital into local companies and thus translate into an "increase in share prices"[2], but it does not sufficiently consider the impact on the investment choices by local investors and the flow on effects. Specifically, a lower company tax rate would proportionally increase the profits of a company due to lower tax costs, only if all things remain equal. It does not definitively compensate local or foreign shareholders as there is no guarantee that real profits will increase and is thus not a guaranteed return. Furthermore, there is no guarantee that an increase in share price will accrue, as this cannot be guaranteed at any time in the market.

It is also highly probable that no increase in the share price will accrue due to the increased demand for local shares by foreign investors due to it being offset by the fall in investment from local investors whose returns have fallen due to the double taxation. A lower company tax rate does not address the inequality of double taxation of dividend income, because the sum of the tax being paid twice by local investors will likely exceed any unlikely increase in the share price due to a reduction in the company tax rate.

Consequently, if double taxation were to apply to both local and foreign investors, it is unlikely that replacing dividend imputation with a lower company tax rate will result in a large increase in foreign investment as foreign investors will still be taxed twice on dividend earnings from their investments, i.e. by the Australian government and their local government. Furthermore, double taxation would now apply to both local and foreign investors, with the only outcome being that it will likely provide some degree of deterrent to local investors as they consider investing in local companies, when the ruler is drawn over their proposed investment mix for the next 6 months.

3. LOSS OF DIVIDEND IMPUTATION WILL IMPACT UPON JOBS.

The loss of dividend imputation will increase the costs of local share ownership for local investors and thus make buying shares in local companies less attractive to local investors. This will result in a reduction in the returns going to local citizens and local companies that choose not to invest in local companies, which has the flow on effect of reducing the money spent in Australia and negatively impacting on local jobs, most notably in the consumer orientated sectors upon which a large percentage of Australia's GDP is derived.

Furthermore, any proportional increase of foreign investment in local companies relative to local investment will result in an increase in capital outflows. Specifically, it will result in an increase in capital outflows due to the outflow of returns derived from the increased foreign investments, which will likely offset any unlikely increase in capital inflows due to a lower company tax rate and negatively impact on Australia's capital account.

4. REDUCED RETAIL INVESTING INCREASES THE BURDEN ON THE TAX SYSTEM.

The other negative side effect of reduced investment in shares by Australian citizens is an increased burden on the tax system due to the increase in pension payments likely to be claimed to support the loss of dividend income. Specifically, a fall in investment in shares by local investors will result in a reduction of income and assets, and result in an increase in the eligibility for government pensions and/or payments.

It has been stated that the "Dividend imputation foregoes more than $20 billion per year"[3], and that "abolishing dividend imputation could fund a wholesale cut in company tax from 30 percent to somewhere around 19 percent"[3]. If the $20 billion in revenue saved each year is then to be used to fund a reduction in the company tax rate, i.e. fund a $20 billion short fall in company tax revenue, there is no gain or loss in revenue for the Commonwealth, which implies a zero sum gain or "null event".

However, my points show that the costs from this proposal will more than likely offset any possible policy gains made from this "null event", resulting in more negatives than positives for the local tax system, local jobs, the local economy and the standard of living. The negative impact of this proposal will also be skewed to a greater extent towards seniors, "mum and dad investors" and retirees who are already reeling from the massive losses imposed on them by the global financial crisis. This will further diminish the spending power, and thus further contribute to, and lengthen the impact of the local recession on local jobs.

5. DOUBLE TAXATION SENDS A BAD MESSAGE TO YOUTH.

Share ownership also contributes to the long-term wealth of citizens, and the country. It generates significant wealth effects that buoy consumer confidence upon which the retail sector and the housing sector depend upon to a large degree. Strong consumer confidence also has a significant positive flow on effect for the overall strength of the economy. Increased share ownership by "mum and dad investors" and seniors over the last three decades has significantly contributed to the wealth effects that were strongly evident over this period and particularly during the recent period of seventeen years of strong economic growth. Specifically, it was instrumental in increasing Australia's national savings and thus indirectly the Australian dollar. It also boosted banking deposits, which in turn supported local bank lending and helped to fuel the resultant positive flow on effects for local households. Furthermore, the higher rate of share ownership of Australians relative to British and US citizens was evident in the higher relative savings rate of Australians to our foreign counter parts which played an underlying roll in helping Australia and its banks to better weather the current financial crisis.

We cannot risk the great chance that a loss of imputated credits will reduce local share ownership. Double taxation of local dividends will discourage those who have saved with the aim of providing for their own future income stream. We cannot risk the likelihood that it may persuade these conscientious citizens and local super companies to look for investments other than local shares, which opposes those claims to the contrary.

Most importantly, the savings and investment ethos evident over the last thirty years maybe lost, as new "mums and dads" and young workers will also be discouraged from investing in shares to provide a supplementary income producing stream for the future. This will remove the many positive flow on effects that occurred due to the wealth effects derived from increased local share ownership most evident during the last three decades.
It is highly likely there will be a larger draw on pensions, and that local superannuation companies and the local companies in which they invest will also suffer, resulting in a negative flow on effect for employment and the overall strength of the economy. Dividend imputation was introduced with the dual aim of removing the disparity between the tax paid on the profits of a private company and the tax on the profits of a public company, and to increase local share ownership. At the same time, we were warned that "Australia will become the best housed third world nation in the world" if our growing preference for housing as the preferred choice of investment continued. We heeded that warning, dividend imputation saved us, while British and US citizens took that bullet.

Thanking You,

Best Regards.

Lorraine Roth
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