Sir,
Madam,

Dividend Imputation should not be changed
as it produces significant socio economical benefits and has advantages over the alternative double taxation of company profits on the corporate and on the shareholder level.

Dividend imputation acts as an incentive for high pay out ratios and consequently dividend yields which are in Australia double those of Europe and America. Franked dividends have attracted every second Australian to invest directly or via his or her superannuation fund in public companies and created a wide and diversified shareholder base.
Commonwealthbank has 750,000 shareholders compared to 235,000 at the American JP Morgan Chase which is four times in size. 2,000 companies are listed on the Australian Stock exchange compared to 2,400 in Japan. The total market capitalisation of Australian public companies is 2 trillion Dollars compared to 2.5 trillion Dollars for the stock market in Germany whose economy is 3.5 times in size. Even in the present economical crisis the Australian stock market has been capable of meeting increased demand for equity and small investors have put up their savings and participated in the public offerings.

The high pay out rate of corporate profits has put the market in charge of reinvestment of these profits which otherwise would have been re-invested at the discretion of the company. As recent events in America have proven, re-investment at the discretion of the company can lead to serious misallocation of capital resources.

Franked dividends are an integral part of retirement savings and income for working Australians, more so after recent changes to Superannuation Legislation with refunding of franking credits.

Administration of the dividend imputation system is simple and cost effective and discourages tax avoidance.

The imputation system is criticised for discouraging foreign investment in Australia as the foreign investor can not offset the franking credit against foreign income tax. This argument is not true. The classical alternative to dividend imputation is double taxation on the company and on the shareholder level. The shareholder does not receive credit for income tax paid on the company level, as is the case with imputation for the foreign shareholder. On the Australian stock exchange are 250 foreign owned companies listed, compared to 85 in Germany which has the classical system.

The imputation system disadvantages however the foreign investor in comparison to the Australian investor as only the Australian investor receives the franking credit. This disadvantage could be removed by appropriate taxation treaties with foreign countries.

The company tax rate should be reduced by 5 to 10%
as an incentive to attract foreign investment into Australia and make Australian tax rates best praxis. The budgetary implications would be restricted to dividends received by foreign investors who would be taxed with a lower rate. As the Australian income tax rate of 30% kicks in with taxable income of more than 30,000 Dollars and as one has to assume that most shareholders have income in excess of this threshold, income tax generated by Australian residents would not be significantly affected.

Capital gains tax on the sale of shares is often considered as disincentive for investment as compared to foreign countries which do not tax capital gains or tax them only at reduced rates. The argument has to be considered in the context of the overall taxation system.
The United States have a system of double taxation of corporate profits with the consequence of low dividend payments and high retained profits. For the shareholder, the incentive to invest is not primarily the dividend income as in Australia, but the capital appreciation of the shares over time and the eventual realisation of a capital gain. Freeing this capital gain from tax makes sense. As the Australian taxation system reduces income tax on dividends as

the result of imputation, taxation of capital gains can be accepted in particular with concessional rates for individuals. On the corporate level capital gains tax at the normal rate should be accepted, in particular when the tax rate should be reduced by 5 to 10%.

Sincerely

Richard G Zoller
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