

## Introduction

### Referral of the inquiry

- 1.1 On 19 September 2018, the Treasurer, the Hon Josh Frydenberg, MP, referred to the committee an inquiry into Labor's policy to remove refundable franking credits. The terms of reference are reproduced in full in the front pages and the letter of referral is reproduced at Appendix C.
- 1.2 The Treasurer asked the committee to inquire into and report on the implications of removing refundable franking credits and, in particular, the stress and complexity it will cause for Australians, including older Australians to adjust their investments. The Treasurer in his letter to the committee stated:

There is significant concern and uncertainty within the community following the announcement by the Labor Party they will increase taxes on retirees and other savers by removing refundable franking credits.<sup>1</sup>

### Background

- 1.3 In March 2018 the Labor Party (ALP) released a tax policy to end cash refunds for excess imputation ahead of an impending Federal Election due by May 2019.<sup>2</sup> Labor's policy is reproduced at Appendix D. The ALP stated:

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1 The Hon Josh Frydenberg, MP, Treasurer, *Letter of referral to committee*, 19 September 2018, Appendix C.

2 Australian Labor Party, *A Fairer Tax System, Ending cash refunds for excess imputation*, March 2018.

The dividend imputation system introduced by Paul Keating in 1987 was a key plank of the Hawke-Keating economic reforms that has helped underpin Australia's 26 years of recession-free growth. There is no stronger supporter of the original dividend imputation system introduced by the former Hawke-Keating government than the Labor Party. We delivered it. And we support it.

But the Howard Government's decision in 2000 to allow individuals and superannuation funds to claim cash refunds for excess imputation credits is simply unaffordable, and will impede the ability of future governments to pay for good-quality health and other services.<sup>3</sup>

- 1.4 The ALP noted that the 'dividend imputation system was introduced in 1987 by Paul Keating to ensure that the profits of companies in Australia are only taxed once for Australian investors.' Imputation credits could be attached to dividends equal to any company tax paid on the company's profits and 'these credits could then be used to reduce an individual's tax liabilities.'<sup>4</sup> The ALP stated:

If someone didn't have a tax liability, or the tax liability was smaller than the imputation credits, the imputation credits went unused. No cash refunds were paid.<sup>5</sup>

- 1.5 Prior to dividend imputation 'company tax profits were taxed twice: once as a company income and again as personal dividend income.'<sup>6</sup> The system introduced by Treasurer Keating ended double taxation. The ALP stated:

...suppose a company generates a profit of \$100 and under current company tax arrangements pays \$30 in tax (30% company tax rate x \$100 profit). The company decides to pay out the full \$70 out in dividends to shareholders. Because the company has already paid \$30 in tax on this company income, it attaches \$30 worth of "imputation credits" (often referred to as franking credits) in addition to the \$70 dividend. This means the shareholder now has \$70 cash, plus \$30 of imputation credits – a grossed up dividend of \$100.<sup>7</sup>

- 1.6 The ALP then contrasted this tax treatment with the changes made by the Howard Government in 2001. The ALP stated:

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3 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 1.

4 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, pp. 1-2.

5 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 2.

6 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 2.

7 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, pp. 2-3.

Under the Howard-Costello changes, using the same example, shareholders who received this \$30 imputation credit could use it to reduce their tax liabilities at tax time (as under the original dividend imputation system), but they could also claim it as a cash refund if the value of their imputation credits exceeded their tax liabilities.

The ability to claim cash refunds has become particularly attractive to self-managed superannuation funds because in pension phase assets are already tax free, which typically means the total value of any imputation credits received can be claimed as cash refunds.<sup>8</sup>

- 1.7 Treasurer Frydenberg in particular sought advice from the committee on the 'stress and complexity it will cause for Australians, including older Australians to adjust their investments.'<sup>9</sup>
- 1.8 The ALP noted that the budgetary impact of continuing with refundable franking credits is significant. The ALP commented that when the policy began it cost just \$550 million a year but if the policy continues 'future governments will be faced with an \$8 billion annual hole in the budget over the medium term.'<sup>10</sup> The ALP claimed that 'recipients of cash refunds are typically wealthier retirees who aren't PAYG tax payers' and 'who typically own their own home and also have other tax-free superannuation assets.'<sup>11</sup> The ALP concluded that:

Labor will unwind the 2000 Howard Government decision that introduced cash refunds for excess imputation credits for individuals and superannuation funds.

This means that imputation credits for individuals and superannuation funds will no longer be a refundable tax offset, and will return to being a non-refundable tax offset consistent with the tax treatment of most other tax offsets. Cash refunds will not arise if excess imputation credits exceed tax liabilities.

Labor's policy will only apply to individuals and superannuation funds, and therefore will not apply to bodies such as:

- ATO endorsed income tax exempt charities; and
- Not-for-profit institutions (e.g. universities) with deductible gift recipient (DGR) status.<sup>12</sup>

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8 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 3.

9 *Terms of Reference*

10 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 3.

11 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 5.

12 ALP, *A Fairer Tax System, Ending cash refunds for excess imputation*, p. 7.

- 1.9 Shortly after the ALP released its policy there was community opposition about its impact on retirees. The ALP then amended the policy to include a Pensioner Guarantee. The ALP stated that under the Pensioner Guarantee:

Every recipient of an Australian Government pension or allowance with individual shareholdings will still be able to benefit from cash refunds. This includes individuals receiving the Age Pension, Disability Support Pension, Carer Payment, Parenting Payment, Newstart and Sickness Allowance.

Self-managed Superannuation Funds with at least one recipient of an Australian Government pension or allowance as at 28 March 2018 will be exempt from the changes.<sup>13</sup>

## Reasons for the inquiry

- 1.10 When the inquiry was referred to the committee the Shadow Treasurer, the Hon Chris Bowen, MP, claimed that it was not an appropriate use of the committee. This would be based on the view that a key function of a parliamentary committee is to scrutinise the executive. A fundamental role of a committee is to scrutinise the executive but it is not the only one.
- 1.11 Standing order 215(c) provides for House Committees to inquire into annual reports of government agencies and reports of the Auditor-General. These are key mechanisms by which committees can unilaterally decide to scrutinise the executive. The House Economics committee uses the annual report power to scrutinise the Reserve Bank of Australia, the Australian Competition and Consumer Commission, the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority. During the current parliament, the committee has conducted 15 inquiries into these agencies based on its annual report power. This is more annual report inquiries than all other House committees combined. The committee fully understands the importance of scrutinising the executive and it performs this function to a high degree.
- 1.12 Standing order 215(b) provides for a committee to inquire into and report on a matter referred to it by a Minister. These inquiries can be wide ranging policy inquiries and are not primarily about scrutinising the

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13 The Hon Chris Bowen, MP, Shadow Treasurer, A Fairer Tax System: Dividend Imputation Reform, *Media Release*, [www.chrisbowen.net/issues/labors-dividend-imputation-policy/](http://www.chrisbowen.net/issues/labors-dividend-imputation-policy/)

executive although it is usual for relevant government agencies to appear and be scrutinised over current administration and legislation.

- 1.13 The inquiry into the implications of removing refundable franking credits serves important public interest outcomes notwithstanding that it is an opposition policy. Close to a million Australians will be affected by the policy, many of them older Australians who have structured their finances around the policy. It is important that the Parliament be appraised of the implications of this policy, effective 1 July 2019.

## The dividend imputation system

- 1.14 The Parliamentary Budget Office (PBO) stated that dividend imputation applies to some Australian sourced dividend income 'reducing the amount of income tax paid by Australian resident shareholders.'<sup>14</sup> The PBO stated:

Under the dividend imputation system, Australian resident companies that distribute dividends from after-tax profits have the option of passing on franking credits (also known as imputation credits) to their shareholders, attached to the dividends they receive. This provides shareholders with a credit for the tax that a company has paid on its profits.

Shareholders include an amount equal to the franking credit attached to their dividend in their assessable income for tax purposes. Australian residents and complying superannuation funds are entitled to claim a tax offset equal to the amount of franking credits included in their income.

This franking credit tax offset can be used to reduce a taxpayer's tax liability from all forms of income. Currently, any excess franking credits are refunded to the taxpayer by the Australian Taxation Office (ATO).<sup>15</sup>

- 1.15 The dividend imputation system was introduced in 1987 by the Hawke/Keating Government but the system at that stage did not include the provision for refundable franking credits. This next step was taken in 2001 by the Howard/Costello Government.

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14 PBO, Policy Costing, *Dividend imputation credit refunds*, PR18/00145, p. 1. The PBO's policy costing is reproduced at Appendix E.

15 PBO, Policy Costing, *Dividend imputation credit refunds*, PR18/00145, p. 2.

## Hawke/Keating government 1987 reforms

- 1.16 Until 1987 company dividends were being taxed twice. First, the company would pay company tax and then issue dividends to its shareholders. For shareholders the dividends would then be counted as assessable income together with any other assessable income and they would be taxed on the total assessable income.
- 1.17 The then Treasurer, the Hon Paul Keating, MP, on introducing the reforming legislation, commented that this 'will give effect to the most significant business taxation reform in this country in the post-war years—the elimination of the double taxation of company dividends.'<sup>16</sup> Mr Keating stated that
- ...under the imputation system, dividends paid by Australian companies will be relieved from tax in the hands of resident individual shareholders by a rebate to the extent to which tax has been paid at the corporate level. Dividends relieved from tax in this way will be known as franked dividends.<sup>17</sup>
- 1.18 Mr Keating noted that the system would be a world first. He stated:
- For resident individual shareholders on lower rates, imputation credits attached to franked dividends will exceed the tax payable on the franked amount of the dividends. The excess rebate will be available to offset tax on other income, including unfranked dividends and capital gains, but will not be refundable where it exceeds such tax, and will not be offset against the Medicare levy. Imputation credits attached to franked dividends will not form part of separate net income for dependent rebate purposes, but will be included in the Medicare levy tax base.<sup>18</sup>
- 1.19 In relation to investment incentive and business growth, Mr Keating stated:
- ...it will restore the position of the stock market as the mobiliser of investment funds and reduce the previous bias in favour of corporate debt finance over equity; it will mean that entrepreneurs trying to get new businesses off the ground should find it easier to raise equity finance; it will make investment in these enterprises relatively more attractive for investors; it will improve the climate for productive investment and enhance economic growth for Australia; and it will provide increased incentives for all
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16 The Hon Paul Keating, MP, Treasurer, *House of Representatives Hansard*, 2 April 1987, p. 1944.

17 The Hon Paul Keating, MP, Treasurer, *House of Representatives Hansard*, 2 April 1987, p. 1944.

18 The Hon Paul Keating, MP, Treasurer, *House of Representatives Hansard*, 2 April 1987, p. 1944.

Australians to participate in the ownership of Australian companies by significantly reducing taxes on dividend income.<sup>19</sup>

## Howard/Costello government 2001 reforms

- 1.20 In 2001 the Howard/Costello Government extended the policy of the Hawke/Keating Government to 'provide for excess imputation credits to be refunded to Australian individuals, complying superannuation funds or similar entities who, until now, could not use those credits because their tax liability was insufficient.'<sup>20</sup> The then Treasurer, the Hon Peter Costello, MP, stated:

At the moment, where a company pays a franked dividend at 36c and the franked dividend is distributed to somebody, let us say a pensioner, who is on a tax rate lower than 36c – maybe 20 cents in the dollar – that person has a dividend on which there is a tax credit of 36 cents in the dollar but is only liable for tax at 20 cents in the dollar. Until now, they have never had the opportunity to get back that excess imputation credit, which, of course, represents an overpayment of tax in their hands. The government foreshadowed its intention to introduce this measure in A New Tax System and it will be of particular benefit to many self-funded retirees.<sup>21</sup>

- 1.21 The then Shadow Treasurer, the Hon Simon Crean, MP, stated:
- Although imputation credits can be used to reduce an individual's or a superannuation fund's income tax liability to nil, excess credits were of no value to taxpayers. This bill proposes to refund to taxpayers any excess imputation of credits that may be left after offsetting the credits against their income tax liability. The classic example of such a situation is a low income person who earns a little investment income – for example, a full rate age pensioner. They face no income tax liability on their income and therefore cannot obtain the benefit of the excess franking credits attached to the small amount of dividend income they receive. Under this proposal, they will obtain a refund of their income tax from the Taxation Office, representing the excess imputation credits. Labor included this proposal in our taxation policy prior to the last election. Therefore we have no difficulty supporting the proposal because it is our policy. It builds on the major reform

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19 The Hon Paul Keating, MP, Treasurer, *House of Representatives Hansard*, 2 April 1987, p. 1944.

20 The Hon Peter Costello, MP, Treasurer, *House of Representatives Hansard*, 9 December 1999, p. 13193.

21 Mr Costello, MP, Treasurer, *House of Representatives Hansard*, 9 December 1999, p. 13193.

accomplished by Labor almost 15 years ago and it improves the current taxation situation faced by low income investors, especially retired Australians.<sup>22</sup>

## Scope and conduct of the inquiry

### Privilege claim raised against the Chair, Mr Tim Wilson, MP

1.22 On 13 February 2019, the Leader of Opposition Business in the House, the Hon Tony Burke, MP, pursuant to standing order 51, rose in the chamber and raised a privilege claim against the Chair, Mr Tim Wilson, MP, for his conduct relating to the inquiry into refundable franking credits. First, Mr Burke claimed that Mr Wilson organised a public hearing on the same day and in close proximity to an investor roadshow organised by Mr Geoff Wilson of Wilson Asset Management (WAM) who is a vocal critic of Labor's policy. Mr Burke stated:

On 20 November 2018, the committee did hold a public hearing of the inquiry – at the Law Society of New South Wales at 170 Phillip Street, Sydney. The committee's public hearing occurred on the same day and some 400 metres away from the shareholders' presentation organised by Mr Geoff Wilson. This raises a question as to whether the chair organised the committee's hearing schedule and locations at the behest of a person with a vested interest in the inquiry. This also raises a question as to whether the actions of the chair amount to an improper interference with the free exercise of his own committee's authority or functions such as to constitute a contempt of the House.<sup>23</sup>

1.23 Mr Burke next noted that Mr Wilson is also a shareholder in two WAM investments. Mr Burke stated:

The fact that it has since been revealed that the chair is also a shareholder in two Wilson Asset Management investments raises other concerns about his conduct. It also raises questions over the chair's reported failure to declare this obvious conflict of interest to the committee, including when Mr Geoff Wilson appeared before a public hearing of the committee on 30 November 2018 while it was being chaired by the member for Goldstein [Mr T Wilson]. I note that at one point during the hearing Mr Geoff Wilson spoke

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22 The Hon Simon Crean, MP, Shadow Treasurer, *House of Representatives Hansard*, 17 February 2000, p. 13730.

23 The Hon Tony Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13268.



about his shareholders, and the chair even then failed to declare his obvious conflict of interest. Again, this raises the question as to whether the chair's actions amount to an improper interference with the free exercise of his own committee's functions so as to constitute a contempt of the House: by chairing a hearing and asking questions of a committee witness when other committee members and, indeed, the people attending the hearing were not aware that he had a pecuniary interest in investments run by that witness. It also raises the question whether the chair is in breach of standing order 231 —<sup>24</sup>

1.24 Mr Burke noted that 'one of the Wilson Asset Management investments which Mr Wilson holds is through his self-managed superannuation fund, meaning that in his retirement Mr Wilson may be impacted by the very policy his committee is inquiring into.'<sup>25</sup>

1.25 The third issue raised by Mr Burke relates to Mr Wilson setting up his own website relating to the inquiry, partially funded by Mr G Wilson and other unnamed individuals. Mr Burke claimed that the website included the ability to submit to the committee a prefilled submission which states it is against Labor's policy. Mr Burke stated that 'clearly this will mean that a number of the submissions received by the committee will have been written by the chair of the committee to himself, and that when the committee writes its report it will use evidence written by the chair.'<sup>26</sup> Mr Burke also stated in relation to Mr Wilson's website that:

Equally concerning is that, from when the chair's website was set up until the beginning of February this year, people could only register to attend a public hearing of the inquiry on the website by agreeing to be registered for a Wilson Asset Management petition against Labor's policy. However, this again raises a question as to whether the chair improperly interfered with the free exercise of his own committee's functions such as to constitute a contempt of the House.<sup>27</sup>

1.26 Mr Burke also raised issues about the conduct of the public meetings. Mr Burke stated:

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24 Mr Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13268.

25 Mr Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13268.

26 Mr Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13268.

27 Mr Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13269.

It is also reported that at a public hearing of the inquiry on 30 January this year the chair did nothing when the member for Fisher called for people to join the Liberal Party while he was giving evidence to the committee, and then reportedly allowed the handing out of Liberal Party membership forms to people at the hearing.<sup>28</sup>

- 1.27 The Speaker, the Hon Tony Smith, MP, heard the issues raised by Mr Burke and pursuant to standing order 51(b)(ii) reserved the matter for further consideration. Only if the Speaker grants precedence to the matter under standing order 51(b)(i) may the member then move a motion declaring that a contempt or breach of privilege has been committed.
- 1.28 On 21 February the Speaker addressed the chamber in relation to the matter noting that there were no grounds to grant precedence to a motion that a contempt or breach of privilege had been committed by the Chair. The Speaker stated:

I appreciate the concerns that may have been raised by the actions of the member for Goldstein and the actions could be seen to have caused damage to the committee's reputation and the reputation of the House committee system more generally. However, I do not believe that evidence has been presented to demonstrate that the member for Goldstein's actions have prevented the committee in a fundamental way from continuing to fulfil its basic responsibilities in relation to its inquiry work. I therefore do not propose to give precedence to a motion to refer the matter to the Standing Committee of Privileges and Members' Interests.<sup>29</sup>

- 1.29 While the Speaker did not support Mr Burke's claims, he stated that Mr Wilson's actions were unconventional.<sup>30</sup> The Speaker stated:

As I have noted, while I do not believe the actions of the member for Goldstein meet the test set out in section 4 of the Privileges Act, I believe his actions have not always conformed with what I see as the conventions usually observed by chairs of House committees and the practice of House committees. The particular matters I would mention include:

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28 Mr Burke, MP, Manager of Opposition Business, *House of Representatives Hansard*, 13 February 2019, p. 13270.

29 The Speaker, the Hon Tony Smith, MP, *House of Representatives Hansard*, 21 February 2019, pp 14290-91.

30 The Speaker, the Hon Tony Smith, MP, *House of Representatives Hansard*, 21 February 2019, p. 14291.

- having a private website 'authorised by', and with the badging of, the chair of the committee, which appeared to solicit submissions and attendees at public hearings from just one perspective; and
  - apparently arranging for a public hearing of the committee to coincide with the meeting of a group with an active interest in the committee's inquiry, including with the possible intention to engage in protest activity at the hearing.<sup>31</sup>
- 1.30 In addition, the Speaker was particularly critical of local Federal Members handing out party political material at the committee hearing venue. The Speaker commented that 'the handing out of party political material or the display of signs by individual members at hearings of parliamentary committees should not be tolerated by chairs.'<sup>32</sup>
- 1.31 In response the Chair clarified his intention was to promote public participation, stating 'the objective of this inquiry at every point is to maximise and increase the participation of Australians in their Parliament and make sure that people have the opportunity to have their say.'<sup>33</sup>

## Submissions

- 1.32 The details of the inquiry were published on the committee's webpage, and a media release was issued seeking submissions. The committee received and published 1777 submissions, which are listed in Appendix A. In addition, there were 1,108 identical form letters.
- 1.33 The submission deadline was set for 2 November 2018 although it became clear during the inquiry that due to the massive interest by the public documents continued to be sent to the committee. All documents sent to the committee were received and considered by the committee. However, due to the large number of documents received not all submissions were published by the time the committee reported.

## Public meetings

- 1.34 The committee held a series of public hearings where individuals could make short statements of up to three minutes. This helped to maximise participation. Organisations and stakeholder groups also appeared at

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31 The Speaker, the Hon Tony Smith, MP, *House of Representatives Hansard*, 21 February 2019, p. 14291.

32 The Speaker, the Hon Tony Smith, MP, *House of Representatives Hansard*, 21 February 2019, p. 14291.

33 The Chair, Mr Tim Wilson, MP, *House of Representatives Hansard*, 21 February 2019, p. 14292.

public hearings where they were given more time to present their case and be subject to questioning.

- 1.35 Public hearings were held in Sydney, Melbourne, Dee Why, Townsville, Alexandra Headland, Paddington (Queensland), Eight Mile Plains, Upper Coomera, Merimbula, Chatswood, Bondi Junction, Carlisle, Guildford, Norwood, Malvern, Brighton, Mount Martha, Torquay and Canberra.
- 1.36 The hearings were webcast through the Australian Parliament's website, allowing interested parties to view or listen to the proceedings as they occurred. Hearing witness details are provided in Appendix B.
- 1.37 Submissions and transcripts of public hearings are available on the committee's webpage at: <https://www.aph.gov.au/FrankingCredits>