The Parliament of the Commonwealth of Australia

Report on the inquiry into the implications of removing refundable franking credits

House of Representatives
Standing Committee on Economics

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Canberra

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Foreword

On 19 September 2018, the Treasurer, the Hon Josh Frydenberg, MP, referred to the committee an inquiry into the removal of refundable franking credits. 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 who will be impacted in their retirement.

The public response to the inquiry has been extraordinary. The committee held a series of 19 public hearings across the country to allow Australians to have their say in light of a policy proposed to be introduced on 1 July 2019. These hearings were very well attended – often exceeding 300 people. A total of 1777 submissions were published and many more documents were received that could not be published by the time the committee reported.

While the participation in the inquiry was high, worryingly the evidence suggests that many people at risk of being impacted from a policy change are unaware of the proposal that could result in them losing a third of their income. This risk is particularly concerning when many retired Australians live outside of capital cities and are at a vulnerable stage of their life.

While the public discussion surrounding the abolition of refundable franking credits has focused primarily on retirees, the committee heard evidence from others who need certainty in their lives and who are at risk. These include mothers who have taken a break from employment to have children, those earning below the tax free threshold and people with a disability with ageing parents who have income from shares to maintain independent living.

The committee has considered the case for removing refundable franking credits for individuals and SMSFs and is of the view the policy is inequitable and deeply flawed.

Franking credits play an important role in Australia's tax and dividend imputation system. Franking credits are a tax credit for imputed tax to the individual to stop double taxation. They are stated on an individual's tax assessment notice as withheld tax, and are used to assess an individual's taxable income at the end of the financial year and for access to other benefits such as healthcare cards. Franking credits are only received when tax is paid.

Their abolition for refundability while still being considered as part of taxable income is poor tax policy and discriminates between taxpayers.

Those who made their voice heard put worrying stories to the inquiry.

Many affected retirees spoke of anxiety from the fear of losing a third of their income. There's Karen's story of 'exhausting and soul destroying' stress.

Others raised concern that abolishing refundable franking credits would compound the legacy of the gender pay gap. There's Margaret's story of historic sexism and how 'too many people making decisions for us' are 'totally unaware of history and our lives'.

And then there are straight stories of financial hardship. There's Michael's story of medical challenges and how the removal of refundable franking credits will cause him 'considerable hardship'.

In particular, abolishing refundable franking credits will unfairly hit people of modest incomes who have already retired, and who are unlikely to be able to return to the workforce to make up the income they will lose.

The abolition of refundable franking credits will force many people, who have saved throughout their lives to be independent in retirement onto the Age Pension. This undermines any objective that it may raise revenue and reduce dependence on taxpayers resulting from an ageing population.

Some have argued that the intention to scrap refundable franking credits is designed to tax the wealthy. This is an unfair characterisation of the 900,000 Australians who will be affected and could lose up to a third of their income.

It also does not take account of the introduction of the transfer balance cap in the 2017/18 financial year that applied a 15 per cent tax rate on income earned on balances above $1.6 million. These funds will continue to enjoy the use of franking credits to fully offset their tax liability, while those under $1.6 million will not. Such inconsistency will apply an effective 30 per cent tax rate on the income of those with superannuation balances below $1.6 million, and a maximum 15 per cent on those above $1.6 million.

Abolition of refundable franking credits is fundamentally regressive. Australia has a tax free threshold of $18,200 for workers, yet the abolition of refundable franking credits would apply an effective 30 per cent tax from the first dollar earned.

The fact-free dehumanisation of franking credit recipients has made it easy to dismiss the concerns of the over 900,000 Australians impacted.

The Alliance for a Fairer Retirement System claims that, in 2014-15, over half of those receiving cash refunds for their franking credits had incomes below the $18,201 tax-free threshold of the time, and 96 per cent had taxable incomes of less than $87,000. These Australians are hardly high income earners, yet they stand to lose up to 30 per cent of their income overnight.

Such a policy discriminates against retirees in SMSFs, in favour of members of APRA-regulated industry and retail superannuation funds, and those eligible to receive a part or full Aged Pension before 28 March 2018.

The policy may also reduce the value of some Australian shares and reduce investment in Australian companies.

A range of submitters were concerned about the need to rearrange their investments, and to reduce spending, particularly on private health insurance and charitable donations.

The committee is concerned that these serious policy implications have not been addressed in any proposal that is sought to be implemented.

In consideration of the evidence received during this inquiry, the committee strongly recommends against the removal of refundable franking credits.

Any policy that could reduce Australian retirees' income by up to a third should only be considered as part of an equitable package for comprehensive tax reform.

Tim Wilson MP
Chair

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Membership of the Committee

Chair	Mr Tim Wilson MP (from 10 September 2018)
Deputy Chair	The Hon Matt Thistlethwaite MP
Members	Mr Adam Bandt MP
	Ms Julia Banks MP (to 28 November 2018)
	Mr Trevor Evans MP
	Mr Jason Falinski MP
	Mr Craig Kelly MP
	Mr Matt Keogh MP
	The Hon Craig Laundy MP (from 10 September 2018)
	Mr Ted O'Brien MP (from 18 February 2019)
	Mr Josh Wilson MP (from 10 September 2018)

Committee Secretariat

Secretary	Mr Stephen Boyd
Inquiry Secretary	Dr John White
Office Manager	Ms Jazmine Rakic

Terms of reference

On Wednesday, 19 September 2018, the Treasurer, the Hon Josh Frydenberg MP, asked the committee to inquire into and report on the use of refundable franking credits, their benefits and the implications of their removal, including:

- analysis of who receives refundable franking credits, the opportunities it provides to offer alternative savings and investment vehicles to low and middle income earners, and the impact it has on lowering tax bills
- consideration of how refundable franking credits support tax principles, particularly implications for tax neutrality, removal of double taxation and fairness
- if refundable franking credits are removed; who it would impact and how and the implications from expected behavioural change by investors, including for
  - ⇒ increased dependence on the pension
  - ⇒ stress and complexity it will cause for Australians, including older Australians to adjust their investments
  - ⇒ if there are carve outs applied, what this might mean for additional complexity, uncertainty and fairness
  - ⇒ reduced incentives to save and distortions to which asset classes are invested in and funds are used, and
  - ⇒ the reliability of providing a sustainable revenue base over the longer term.

List of abbreviations

ACOSS	Australian Council of Social Service
the Alliance	The Alliance for a Fairer Retirement System
ALP	Australian Labor Party
APRA	Australian Prudential Regulation Authority
ASA	Australian Shareholders' Association
PBO	Parliamentary Budget Office
SMSF	Self-managed superannuation fund

Recommendations

Recommendation 1 (paragraph 2.76)

The committee recommends against the removal of refundable franking credits.

Recommendation 2 (paragraph 2.77)

The committee recommends any policy that could reduce Australian retirees' income by up to a third should only be considered as part of an equitable package for wholesale tax reform.