Submission to the House of Representative economics committee

The implications of the removal of franking credits

20 September 2018

Dr Robert G B Morrison

Background

I am a retired academic; my wife was for some years a teacher, then a part-time carer and then self-employed. While I have a small pension from my academic service, we have a joint Self-Managed Super Fund (SMSF), most of which consists of investments in Australian securities. These were selected over the years under the various regulations and assurances of successive governments for their dividends and franking credits. We have calculated these carefully to ensure that they provide sufficient income to sustain us without our having to apply for a pension. Labor has dismissed people like us as 'rich.' We are far from rich, both being in receipt of the government's health care card, which is only provided to those with an income low enough to be deemed worthy of support.

I am 76, my wife slightly younger. Neither of us is now earning income beyond a few small freelance jobs from time to time. The successive changes to superannuation imposed by various governments, despite promises not to change it, now place us in a position where I cannot add to our Super Fund because of my age and my wife cannot do so because of her lack of an employer. Should this policy eventuate we will thus face the removal of franking credits from our superannuation through government edict on one hand and the inability to supplement our superannuation by government edict on another.

While I submit that the proposed removal of these franking credits would be unjust and extremely damaging financially to many of our age and both of us, the greater injustice would be to my wife, for reasons set out below.

Injustice to women from the removal of franking credits

The Labor party has, in the past few days, declared they will protect and add to the superannuation of women currently employed. I have no written version of this to hand but have watched a video of Mr Shorten in which he maintains that this will provide 'A fair go for Australian women so they can secure their financial future.'

Perhaps it may for those currently employed, but the removal of franking credits will provide a monstrous injustice to many Australian women who have by now ceased employment, and it will make their futures most insecure. My wife is one of them, and this is the reason.

At the time when we and others of our age married, many (most?) women – who were then without any benefit of paid maternity leave – were forced by the government of the day to resign and needed to cash in their superannuation. In addition they lost any accrued long service leave. We all know the power of having superannuation build over time through compound interest. Even if my wife (a teacher) had been able to take up employment again and resume building superannuation of her own it would have been severely depleted by this governmental requirement. As it was, she became a mother, then a part-time carer of a sick child and then her own ailing mother and finally took up self-employment, which did not confer on her the benefits of having superannuation paid into her account by an employer.

We had to accept that and, in order to giver her security, established a joint self-managed superannuation fund so that she had as much protection as I did for our post-work years. It has been sufficient and we had calculated that, even with the annual drawdown required by government, our dividends and franking credits would be enough to keep us without our needing pensions.

All that is now at risk. The Coalition's imposition of limits to the amount that can be paid into superannuation each year, and the cap placed upon SMSFs, came despite promises that superannuation conditions would not be changed. That was concerning, but our SMSF is nowhere near reaching the cap that has been imposed and I have no way of adding to the SMSF in any case since I am over 75. For us the concerns were academic.

My concerns about the Labor proposition are anything but academic. It will strip from us immediately and annually a very significant part of our income, depriving my wife of a large part of the only superannuation that she has been able to obtain and leaving us unable to take effective measures to compensate; each of these successive problems being caused by a succession of governmental edicts that continually change the rules about how we and others can provide for our old age through our own resources.

<u>The implications for holders of SMSFs</u>

The largest component of our SMSF is shares in fully franked listed investment companies such as Argo and Australian Foundation. These provide us with fully franked dividends that ensure reasonable income from sources that are as secure as the ASX itself. We could get higher dividends from riskier stock, but that runs against all advice for those of our age. Literature on SMSFs shows that ours is a very common strategy, and it also means that many millions of dollars are invested by Australian SMSF holders in a stable way in Australian companies.

The removal of imputation credits would sharply change this picture. In order to ensure that our SMSF earns enough each year to compensate for that loss and the required drawdown, I will have to move investments to riskier stock and almost certainly international shares to get anything that equals the franked dividend income currently offered by Australian stock.

Should that strategy fail we would, of course, have to apply for pensions, incurring costs for the Australian taxpayer that we do not incur now and will not incur if we are able to retain franked dividends. A great deal of money would also flow out of Australian companies to countries overseas. Assuming that others in our position do the same (and investment advisers are already suggesting this as a strategy to SMSF owners), that will be in the order of many millions of dollars.

An example.

Argo offers a dividend of around 4% but, for those in an SMSF in pension phase, the additional franking credits make that around 6+% (approx) – a reasonable return on a safe investment. Remove the franking credits, and the 4% is insufficient to make the SMSF income sustainable.

Centamin, a gold mining company in Egypt, started in Australia and was listed on the ASX but subsequently delisted here and is now listed on the Canada and London exchanges as CEY. It currently offers a dividend of more than 8%, franking is not an issue and it is rated (and has been for a long time) as a strong buy. I retain some shares bought long ago when it was ASX listed.

While it would seem foolish to move a large amount of money into a speculative gold company like Centamin when you are 75, the return of more than double the dividend that could be earned compared with an Australian LIC with the franking credits removed would certainly be tempting, and there are many international companies – including LICs and EFTs – that offer returns far greater than those from similar Australian investments that have had imputation credits stripped from their dividends.

Should such a gambit be unsuccessful, there will be the pension to fall back on, resulting in a greater cost to the Australian government, while a substantial amount of Australian money will by then be in Egypt or the USA, a loss all round.

An arbitrary injustice

While the Labor party, following its initial announcement of this proposed policy, has backed down and announced that pensioners will be exempt, there seems no rational argument behind this back down other than the superficial one of not appearing to hurt existing pensioners. The Labor declaration that this move will only disadvantage the rich is patently false. There are those not currently on pensions who are only avoiding being on them because they have franking credits as income. Without those credits, some will be worse off than others currently drawing a pension, whose ranks they will promptly join.

Those who are receiving a taxable income are told that they will be able to offset the removal of their franking credits, but this will depend on the particular way in which their income is taxed and will produce a very arbitrary outcome. My superannuation pension from my years as an academic will make me a taxpayer until I die, but I am advised that the imputation credits flowing to our super fund cannot be used to help reduce my personal taxation. This policy will have markedly different and arbitrary results on people depending how they have structured their financial affairs, or been forced to structure them, by a succession of ever-changing government regulations.

Potential exemptions

Others will make the point, with which I agree, that imputation credits are not, as they have been portrayed, a bonus for low and non taxpaying recipients. They are part of their justifiable tax refund due to their role as part-owners of Australian companies that have already been taxed. All such part-owners are equally entitled to receive them. That point having been made, should this regrettable policy come into play, I would request that the committee consider the following possible amendments.

1. Exemptions for those who qualify for the Commonwealth Health Card. This would require no new mechanism to be set up as the card is already only available to those whose income is low enough to warrant support

2. Exemptions for those over 75 who, by laws imposed by governments of the day, are no longer allowed to add to their SMSF to compensate for the removal of franked dividend income. This would still recognise the imposed cap.

3. Making some allowance for women who, because of historic governmental rulings, have been unable to acquire superannuation that provides them with reasonable security. They were treated much worse than men in this regard and many of them, as is my wife, are dependent on their husband's superannuation through no fault of their own. It would be most unjust now to deprive them of a very significant part of the only superannuation security available to them.

4. Grandfathering as exempt those SMSFs for SMSF holders whose investments have already been made and, because of the investors' age and already imposed rules, cannot be drastically changed without considerable financial and other difficulty. Were this to be done for those SMSFs held by people in their 70s the number will naturally decrease over the years, leaving those who are young enough now to take the imposition of this new policy into account and order their affairs accordingly before they reach the age when government edicts retrospectively make it impossible for them to do so

Robert GB Morrison OAM CF