Committee Secretary
House of Representatives Standing Committee on Economics
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Submission to the Inquiry into the implications of removing refundable franking credits

Dear Sir or Madam,

I welcome the opportunity to make a submission to this Parliamentary Inquiry, which I believe will result in improved policy making in this area that is of importance for the large number of Australians relying on the income from franking credits.

My submission largely deals with the third term of reference: "*if refundable franking credits are removed; who it would impact and how and the implications from expected behavioural change by investors, including for…..*"

I will illustrate this by explaining how non-refund of franking credits would impact the retirement plans and behaviour of my wife and myself.

Our situation

My wife and I are both 60 years of age. My wife retired in 2016 from her nursing career, largely because of health issues that meant she was unable to cope with the physical demands of the job. She has not worked since and there is no prospect of her working again.

I retired from University teaching in December 2017. Our retirement dates were carefully planned while scrimping, saving and investing our funds over many years to ensure adequate amounts to permit a comfortable self-funded retirement with no expectation of drawing on a government aged pension.

Labor's announcement on March 13, 2018 of its plan to deny the refund of franking credits came completely out of the blue, and destroyed our 20 years of retirement planning *within three months of having commenced our actual retirement*. Plans we had made based on stable government tax policy concerning refundable franking credits that had been in place with bipartisan support for 18 years were destroyed. March 13, 2018 is like our personal Pearl Harbour, signifying the sinking of our retirement plans. Like Pearl Harbour, this was an attack without warning. There had been no inkling from Labor that this policy was under consideration, which may have caused people like us to rethink their retirement plans before it was too late.

Impact on our retirement finances

In retirement from employment, we rely entirely on income from our superannuation, which is largely held in a self-managed super fund (SMSF). If franking credits are no longer refundable, our SMSF earnings will be reduced by 23%. Without disclosing the actual amount, this is a significant hit that is too big to ignore, and will mean our retirement standard of living cannot be maintained without finding replacement sources of income such as returning to work, or government welfare support (*Newstart*) before age 67 and then part age pensions once eligible at age 67.

A sudden and ongoing 23% reduction in retirement income from this franking credit policy would be far worse than the impact of the Global Financial Crisis on an Australian investor's income from Australian shares. If we use for comparison purposes a portfolio consisting of equal dollar amounts of large listed investment companies Argo, Australian Foundation, and Milton held through the GFC 2007-11 for the dividends (a reasonable proxy for a conservative investor's diversified ASX portfolio), the change in dividend income each year from the 2007 pre-GFC level is: 2008, +14%; 2009, -2.3%; 2010, -9.3%; 2011, -0.8%.

Impact on investor behaviour- financial

My wife can no longer work for health reasons. To partly offset the financial damage if the policy becomes law I have returned to work on a seasonal short-term part-time casual basis, with less income than pre-retirement and no security of on-going employment.

Counter measures available to us and other older investors to replace the lost franking credit income include:

1. returning to work or delaying retirement. This will not be possible for many older people who are unable to work for health reasons (like my wife) or become unemployed and are unable to find employment. I have found some work after my retirement but this is casual contract work and may not continue.

2. Deplete their superannuation funds sooner than otherwise due to drawdowns and reduced investment returns and qualify for the age pension (part or full), when this would not have been needed under current franking credit policies. In our case there is a 23% annual reduction in superannuation earnings. If drawdowns are maintained to support current lifestyle, it won't be long before the capital is depleted and we qualify financially for the age pension.

   Consider the following scenario:

   a. 68 year old retired couple with $850,000 in financial assets (excluding their home) that are held in a diversified portfolio of Australian shares with a fully franked dividend yield of 4.0%. They are not eligible for any age pension due to assets and income tests.
   b. Income from the shares is $48,571 (including franking credits).
   c. With no refund of franking credits income from the shares is $34,000 (a 30% reduction).
   d. This is less than the full age pension of $35,058 paid by the government to a couple with no savings at all.
   e. With non-refund of franking credits this couple would be better off blowing all of their hard earned savings on the pokies or X-Lotto in the

hope of a big payoff, or cruising the world for a few years spending their nest egg before age 67 and then go on the full age pension.

3. Increased reliance on welfare payments prior to age pension eligibility, then qualifying for a part or full age pension upon reaching pension age. Many people in our situation will have this option available to them.

   Consider the following option available to us if I cannot find work:

   a. revert our superannuation accounts to accumulation mode, paying 15% tax on earnings. After tax earnings to the fund will be no different with 15% tax (tax offset completely by franking credits) *vs*. nil tax in pension mode and no cash refund of franking credits. In accumulation mode no withdrawal is required from the superannuation fund.
   b. As $ in super won't count under the assets test for Centrelink benefits until age 67 we will leave it in the SMSF and draw down on our small assets outside super and borrow against our home equity loan if needed until age 67.
   c. My wife and I would have no income or assets subject to Centrelink tests and would be eligible to claim *Newstart* benefit until age 67 (7 years). This is currently $492.80 pfn each = $25,625 p.a. total. For people over 60 years of age the job-seeking obligations can be met by volunteering, which my wife is already doing anyway.
   d. As we would not be drawing a pension income from superannuation we would also be eligible for a Low Income Health Care card, worth thousands of dollars per annum to us:
      - state government concessions on rates, utilities etc
      - reduced medical bills (bulk-billed by our practice if HCC holder)
      - cheaper prescription drugs under PBS (big saving for us)
      - reduced Medicare safety net threshold and lower out of pocket medical expenses

In our case the strategy outlined under *3a-d* above would leave the government far worse off financially than the status quo of allowing cash refund of franking credits.

Every accountant/financial advisor worth their salt would be advising all of their clients in the same situation to consider doing the same to recoup money lost by the franking credit changes.

If this strategy were adopted widely then the government would not achieve a net saving anything like the amounts that Labor claims.

Impact on investor behaviour- political

I am a Labor supporter who in the last five years has volunteered and campaigned at federal and state elections for Labor, including as a booth captain on election day 2016 for Kate Ellis in the marginal seat of Adelaide.

Labor's franking credits policy is not progressive. It penalises low-income people with direct shareholdings while having no effect at all on high-income people. *Every* *person* in Australia with franked shares in a SMSF stands to lose money from the policy (if enacted), and this makes it more likely that they would need government retirement income support at some point in the future. The policy needs to be rethought, and hopefully scrapped.

Given that my wife and I are faced with a 23% reduction in retirement income from Labor's franking credits policy I will be unable to support or vote for Labor at the next federal election if this policy is taken to the election in its current form. The other three members of my immediate family will also not vote for a party that intends to eliminate the refund of franking credits. We will vote this way in a marginal electorate despite the fact that in most other areas we believe that Labor's policies are superior to the alternatives.

Many Australian investors would be adversely affected by Labor's franking credits policy. Campaigns against the policy have begun already by organizations and members with an interest in the outcome. These campaigns will intensify up to the election, and beyond if a Labor government is elected. Listed investment companies (LICs) have a large number of shareholders who would be affected, and they are opposing the policy and informing their shareholders about the consequences. Two of the largest LICs Australian Foundation and Argo, have 130,615 and 84,261 shareholders, respectively, at June 30 2018.

According to APRA figures, at June 30, 2017 there were 596,516 SMSFs in Australia with an estimated 1.13 million members. Thousands of new SMSFs are established each quarter. Most of these people would be negatively affected by the loss of franking credit refunds. Information and lobbying campaigns are being organized in preparation for the election and many of these SMSF members will become aware how they will be disadvantaged by the policy if it were to become law.

Summary

In summary, I believe that it is grossly unfair for older Australians who have planned their retirement strategy on long-standing tax rules around franking credits to have them suddenly changed. It is too late for many people to change things so they can mitigate the damage caused to their retirement income. The magnitude of the decline in retirement income is large for many people (much worse than the GFC!), and they will change their behaviour to try to reduce the damage. There is likely to be a large increase in the number of people utilising government welfare payments both before and after retirement as a result. This means the net savings to the Government are likely to be much less than the Labor party has forecast with its financial modelling.

Respectfully submitted,

Adelaide
September 21, 2018