The implications of removing refundable franking credits.

Submission to House of Representatives Standing Committee on Economics
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About ACOSS

The Australian Council of Social Service (ACOSS) is a national advocate for action to reduce poverty and inequality and the peak body for the community services sector in Australia. Our vision is for a fair, inclusive and sustainable Australia where all individuals and communities can participate in and benefit from social and economic life.

The implications of removing refundable dividend imputation credits

People have a reasonable expectation and basic right to health and aged care services when they grow older. Governments are under an obligation to guarantee that health and aged care services will be accessible and equitably provided, regardless of a person's economic and social status. This is an essential element of a secure retirement.

Australia can afford to provide a guarantee of decent health and aged care services for everyone. According to Credit Suisse, Australian households are now on some measures the wealthiest in the world.[1] However, in order to deliver on this guarantee, Australia needs an adequate revenue base. The Parliamentary Budget Office estimates that by 2028, a future Federal Government will need to spend over $20 billion a year more (in current dollars), just to fund existing health, aged care and disability services. Australia currently has a relatively low public revenue base, ranked eighth-lowest amongst OECD countries.[2]

One part of the problem is that, as a result of a range of overly generous tax concessions, currently only 16% of individuals over 64 years pays income tax, despite the growing cost of essential health and aged care services and increases in income and wealth among this cohort.

These weaknesses in the income tax base are compounded by the fact that, in addition to not paying income tax, many people relying on income from superannuation who have substantial investments in shares receive imputation credits from the ATO (either directly or through their superannuation fund).

As a matter of tax policy principle, it is not unreasonable for non-taxpayers to receive refunded imputation credits, but it is unlikely that future governments can afford this. In the absence of far-reaching reforms to the tax treatment of superannuation post-retirement, removing refundable imputation credits would be a sensible second-best option.

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[1] Credit Suisse (2018), *Global wealth report*. Available: https://www.credit-suisse.com/corporate/en/articles/news-and-expertise/global-wealth-report-2018-us-and-china-in-the-lead-201810.html
[2] OECD (2017), *Revenue Statistics*.

In the event that such a policy is implemented, the simplest way to protect investors with low income from dividends (if this is considered necessary) would be to allow the refunding of imputation credits up to a modest annual limit.

Those most adversely affected by the removal of refundable imputation credits would for the most part be relatively wealthy people with substantial income from self-managed superannuation funds, who pay little or no income tax due to a combination of the generous tax treatment of superannuation post-retirement and the Seniors and Pensioners Tax Offset. It would be misleading to describe this group as 'low income-earners', as their *taxable* incomes are a poor measure of their ability to pay. Most can well afford to contribute more to the future costs of health and aged care. Removing refundability of imputation credits would be a fairer way to fund those services than other options, including user charges and increasing the Goods and Services Tax.

It is important to note that many people with relatively high incomes who use superannuation and related investment tax concessions to reduce their taxable income are also not contributing fairly towards health and aged care funding through the Medicare Levy.[3]

Further, the policy of refundability of imputation credits was only introduced in 2000 by the Howard Government. It is another example of an overly generous tax concession that was introduced at the beginning of the boom era, undermining the long term sustainability of our revenue base.

The economic implications of removing refundability are unlikely to be substantial. It may, on the other hand, be desirable to reduce the present bias towards dividend payments (as against re-investment) by large domestic companies, and the bias among Australian superannuation funds towards (relatively risky) investments in shares, when compared with their overseas counterparts.

[3] For a more detailed discussion of this issue, see https://www.acoss.org.au/wp-content/uploads/2017/09/ACOSS_medicare-levy-FINAL.pdf .

Recommendations

In order to help finance necessary future expenditures on health, aged care and the NDIS, the public revenue base should be strengthened by:[4]

(1) extending the 15% tax on superannuation fund earnings in the 'accumulation' phase to the 'pension' phase over a five-year period from July 2018 (a 3% increase each year), offset by a 15% rebate for taxpayers over the preservation age whose income (including Age Pension, earnings and investment income) falls below their tax free threshold;
(Revenue: $1.5 billion in 2019-20)

(2) Broadening the income definition for the Medicare Levy from 'taxable income' to 'Medicare Levy Surcharge income' to prevent people from avoiding the Levy through tax shelters such as private trusts, negative gearing or salary sacrifice arrangements;
(Revenue: $1.2 billion in 2019-20)

(3) Considering the removal of refundable dividend imputation credits (above a low annual cap) from individuals and investment vehicles with insufficient personal income tax liabilities to benefit from imputation.
(Revenue: $5.3 billion in a full year).

Key facts

Governments will need to spend much more on health aged care and disability services

The Parliamentary Budget Office estimates that just to maintain existing commitments in health, aged care and the NDIS, governments will need to spend an extra $21 billion a year by 2028.[5]

The announcement of a Royal Commission on Aged Care highlights the risks of under-funding in this area.

Guaranteed access to affordable, good quality health and aged care services is essential to a secure retirement.

Yet few older people pay income tax

In 2014, only 16% of individuals aged 65 years and over paid any income tax.[6]

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[4] More detailed proposals are outlined in our 2018 Budget Priorities Statement at https://www.acoss.org.au/wp-content/uploads/2018/02/ACOSS-Budget-Priorities-Statement-2018-19_FINAL.pdf
[5] Parliamentary Budget Office (2018), *2018-19 Budget: medium-term projections.*
[6] Daley, Coates & Young (2016), *Age of Entitlement: Age-based tax breaks.* Grattan Institute. Available: https://grattan.edu.au/wp-content/uploads/2016/11/879-Age-of-entitlement.pdf

Superannuation funds pay no income tax on their income in respect of accounts in the 'retirement phase' (accounts from which pensions are paid), and most retirees pay no income tax on their superannuation benefits.

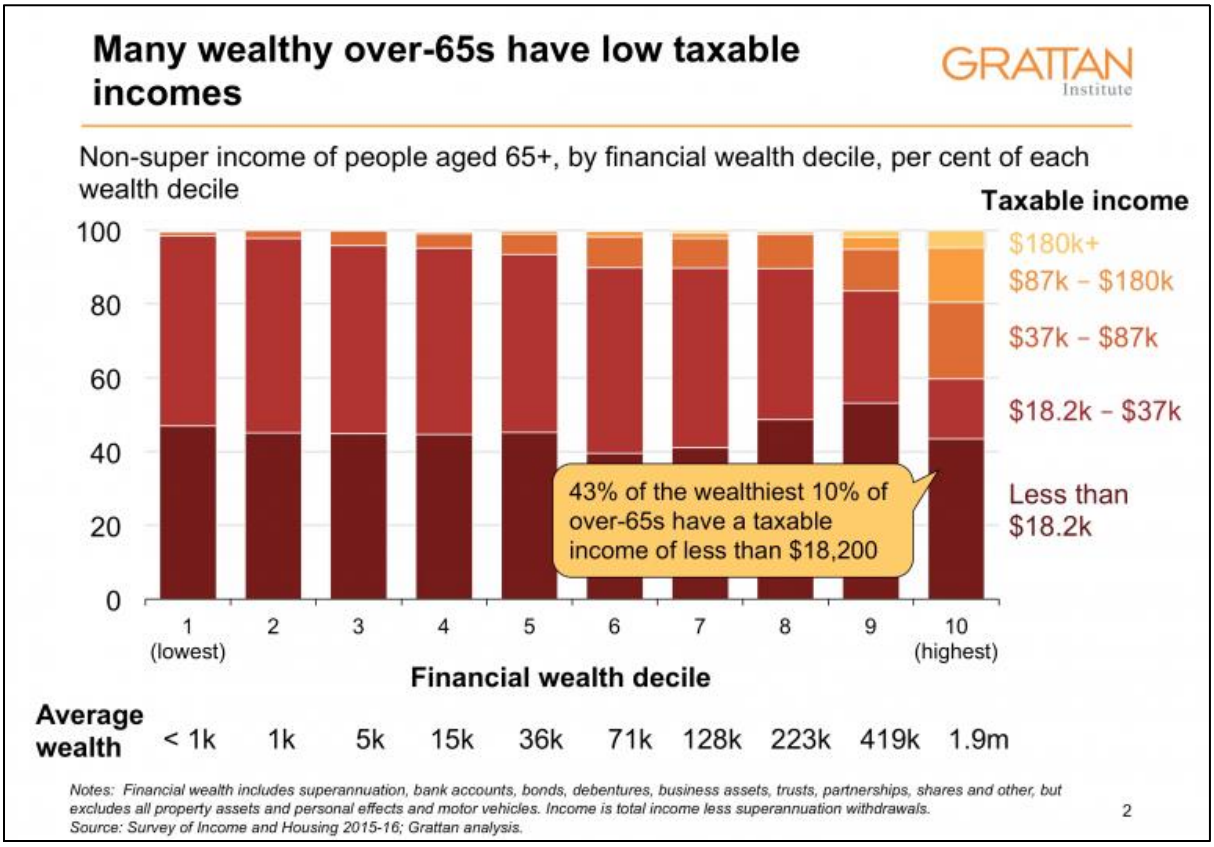
Indeed, overall tax collections on superannuation fund earnings in the retirement phase are *negative*, due to refunded imputation credits.

The share of super fund earnings in the retirement phase will continue to grow as the population ages.

Further, in respect of their *non-superannuation income*, couples aged 65 years and over have a combined tax-free threshold of approximately $60,000.

For retirees, taxable income is a poor indicator of ability to pay

The Grattan Institute estimates that of the wealthiest 10 per cent of people aged 65 and over (whose average wealth is nearly $2 million, excluding the principal residence), almost half report annual incomes of less than $18,200.



Source: Coates B & Wood D (2018), The real story of Labor's dividend imputation reforms, in The Conversation, 20 March 2018. https://grattan.edu.au/news/the-real-story-of-labors-dividend-imputation-reforms/

Direct share ownership is highly concentrated, both among retirees and the general community

The Grattan Institute estimates that the wealthiest 20% of retirees own 86% of all shares held directly by retired people, while the poorest half own less than 2%.

The wealthiest 10% of households generally own over 70% of all shares held directly.

If imputation credits were no longer refunded, those most affected would by definition have substantial shareholdings to draw upon to top up their income.

As a rough rule of thumb, an individual or SMSF in pension phase losing $10,000 a year in refunded imputation credits would hold around $1m in shares (assuming a 4% dividend yield and that the companies in which they invest have an average tax rate of 25%).