

Australia's Future Tax System Consultation Paper - December 2008

ASFA Submission

May 2009

Association of Superannuation Funds of Australia

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Please Note:

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SUBMISSION: AUSTRALIA'S FUTURE TAX SYSTEM CONSULTATION PAPER – DECEMBER 2008

The Association of Superannuation Funds of Australia (ASFA) would like to make this brief submission in response to the *Australia's future tax system* consultation paper released in December 2008. Our submission focuses on the Dividend Imputation System as this is of major importance to the superannuation industry and to retirees who invest in Australian companies in order to derive income to fund their retirement.

One of the questions asked in the consultation paper is "Can the tax system be structured to better attract investment to Australia in a way that increases national income, and if so how? For any given revenue outcome, what are the relative merits of broader base/lower rate (comprehensive income tax) or narrower base/higher rate (a narrow income tax or an expenditure tax) approaches?" While the consultation paper states that "*many submissions support retaining and enhancing the imputation system because it is well understood and liked by Australian investors. Such submissions say a compelling case for abolishing imputation has not been made*" the paper also notes that a few submissions remain open to considering alternatives to dividend imputation.

While ASFA strongly agrees that no compelling case being made for the abolition of dividend imputation, media speculation continues to highlight the possibility of an end to the imputation system being one outcome of the current review.

In this context, ASFA considers that it is appropriate to write in support of the retention of the dividend imputation system.

BACKGROUND

Chapter 6 of the Consultation paper (Taxing Business and Investment) deals with various aspects of the taxation of businesses and investments, including the current dividend imputation system.

As you would be aware, the dividend imputation system was introduced in 1987, bringing to an end the double taxation of Australian resident company profits paid to Australian resident taxpayers. The system operates to ensure that company profits distributed to shareholders are generally taxed only once, in the hands of the shareholder and at the shareholder's marginal tax rate.

The imputation system also provides for taxation equity at the individual shareholder level as the income is effectively taxed at the recipient's marginal tax rate. For shareholders on a tax rate lower than the company tax rate of 30%, the excess credits are offset against other income tax liabilities the shareholders may have, and in some cases are refundable to shareholders. For other taxpayers, additional tax (above the company tax already paid) is levied.

SUPPORT FOR THE CURRENT DIVIDEND IMPUTATION SYSTEM

ASFA considers that the current dividend imputation system provides a fair outcome for all shareholders and is a major reason why Australian superannuation funds invest a substantial proportion of their assets in Australian companies. The following are considered to be the main reasons the current dividend imputation system should be retained:

Removal of double taxation

Without a dividend imputation system, company profits are subject to double taxation. That is, the company profits are taxed in the hands of the company and again in the hands of the shareholders when distributed as dividends.

The absence of double taxation improves the economic return from equity investments and removes an impediment to investing in Australian equities.

Improvement in income streams paid by superannuation funds

Superannuation pensions are a source of income for many Australian retirees. Where the assets backing those pensions consist of Australian equities, the benefits of dividend imputation flow through to those pensioners in the form of higher incomes. This assists in the generation of adequate retirement incomes for Australians. Currently around 3 million Australians receive the benefit of over \$8 billion a year in franking credits. A further \$3.5 billion in franking credits is received by superannuation funds, with around 200,000 Self Managed Superannuation Funds gaining the benefits. Clearly, abolition of the imputation system would have a very substantial impact on millions of Australians – a large proportion of these billions would flow to overseas residents and institutions that have shares in Australian companies.

Incentive to contribute to superannuation

Australians are continually encouraged to invest in superannuation in order to provide for their retirement. In addition, there is much concern and discussion regarding the level of financial adequacy for retirees.

Removing the dividend imputation system, and thus the capacity for the refund of excess franking would provide a disincentive to making discretionary superannuation contributions. It would also have a negative impact on the financial adequacy of retirees.

Reduces tax avoidance/evasion

The current dividend imputation system operates as an anti-avoidance regime as it provides Australian companies with an incentive to pay income tax in Australia rather than off-shore and thus be able to pay fully franked dividends to their shareholders.

In the absence of a dividend imputation regime, Australian companies would be more likely to move taxation obligations off-shore to lower taxing regimes. Australian companies would also be more inclined to use debt rather equity financing, both reducing company tax paid and increasing the risks of instability in financing arrangements associated with volatility of interest rates and availability of debt finance. One of the reasons Australian companies have weathered the Global Financial Crisis relatively well is that they have not generally used excessive levels of debt financing.

Source of long term capital funding

Major superannuation funds currently provide a significant source of long term capital funding for Australian companies. The removal of the dividend imputation regime could see a reduction in this source of long term capital as superannuation funds may look to invest more offshore. This could have a significant impact effect on the Australian stock market and financial system.

While it may be counter argued that the current imputation system discriminates against foreign capital invested in Australia and that the abolition of the imputation system combined with a reduction in the company tax rate will benefit foreign investors, there is no certainty that such a change will attract more foreign capital. In particular small and medium sized businesses in Australia would be extremely unlikely to be able to attract more (or any) foreign capital. What is certain is that it would remove a major incentive for superannuation funds to focus their investment decisions on Australian companies.

ASFA is of the view that not only has no compelling case been made for the abolition of imputation, we believe the imputation system plays a fundamental role in supporting investment in Australian companies and the retirement incomes of Australians. On this basis we strongly support the retention of the current dividend imputation system.

Should you wish any further information please contact Melinda Howes, Director Policy and Industry Practice.

Yours sincerely

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Letter sent on 1 May 2009 to:

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