The Alliance for a Fairer Retirement System

ALLIANCE FACT SHEET

The ALP's policy to remove cash refunds on franking credits was according to Bill Shorten targeted at "the wealthiest 10% of SMSFs[i]". As analysis of ATO data and the Treasury[ii] reveals, however, it is those on modest incomes who will be most affected.

Of the $5.9 billion in franking credit cash refunds disbursed in 2014-15, $2.3 billion went to individuals, $2.6 billion went to SMSFS, $0.3 billion to other super funds and $0.7 billion to tax-exempt entities. In the weeks following the ALP's announcement exemptions were extended to 230,000 individuals and 20,000 SMSFs receiving age pension benefits, and 4,600 tax-exempt entities, such as charities. The Future Fund, which receives the vast majority of tax-exempt entity franking credit refunds, was not included by the ALP in the original policy.

In 2014-15 more than half of those receiving cash refunds (ie. 1.16 million individuals) had incomes below the $18,201 tax-free threshold of the time, and 96% had taxable incomes of less than $87,000. The most severely affected in this group, however, will be the 34% of retirees who take great pride in being self-funded in retirement[iii]. Many of these older Australians have little, if any, superannuation.

Also affected will be SMSFs where almost half of all trustees are over 60 years, and 70% have taxable incomes of less than $100,000. Around 370,000 SMSF member accounts will be impacted, with a median franking credit refund of $5,100. It is also estimated that 40-50 large and 1,963 small APRA-regulated superannuation funds will be affected, with between 2.6 to 3.5 million member accounts[iv].

Who will be affected by the denial of cash franking credit refunds?

- **Australian shareholders who have franking credits that exceed their tax liability**
  Shares have been a preferred saving vehicle for many Australians under the dividend imputation system. Retail investors make up 92% to 99% of shareholders on the register of companies such as Telstra, AMP, IAG, BHP and the major banks. They own 53% of Commonwealth Bank shares and 34% of BHP Billiton shares. Retail shareholders who have franking credits that exceed their tax liabiliyt will be adversely affected, including 18-65-year-olds running their own businesses, single parents, and non-working spouses, that is, those on lower incomes who don't have sufficient non-dividend income to maximise utilisation of the franking credits.

- **Self-funded retirees**
  As at December 2017, just over one third of Australia's 3.6 million retirees were self-funding, and one half of these were over 70.[v] The majority of these older retirees have little if any superannuation savings. Indeed, in the 2015 Household Income and Wealth Survey, 45% of women over 65 reported having no super, and the median super balance for retirees over 70 was nil. Individuals over the age of 65 years receive around half ($1.1bn) of franking credit cash refunds going to individuals, with an average value of around $5,000[vi].

- **Self Managed Super Funds**
  Almost half of the current 1.1 million SMSF trustees who are either in the pension phase, or who will move into that phase shortly, will be adversely affected. In terms of member accounts, SMSFs

are not the province of the super rich! The median member balance of $393,000 is higher than the median across the total super system[1], but given that the median age of trustees is closer to retirement at 58.9 years, that is hardly surprising[2]. The 'pensioner exemption will apply to age pensioners in SMSFs as of the 28 March 2018, but not subsequently. The inequitable impact of this policy will result in the anomalous situation where a retiree on a full age pension with $300,000 in retirement savings in an APRA-regulated fund will receive a significantly greater income than a SMSF retiree who has invested $1m in Australian equities to fund their retirement[vii].

- **Small APRA regulated funds**

While the ALP claims that only 10 per cent of APRA-regulated funds would be affected by the changes, ATO data reveals that 2013 of the 2,603 APRA-regulated funds received franking credit refunds in 2015-16[viii]. 1,963 of these were small APRA-regulated funds with fewer than five people, and with franking credits worth $74m. These funds are in a very similar position to SMSFs when in pension mode.

- **Large retail APRA-regulated funds**

While the Opposition Leader has argued that large retail funds would not be affected, Treasury analysis reveals that 50 out of 240 of the large APRA regulated funds — comprising hundreds of thousands of members — received refundable franking credits worth $235m. The degree to which a fund has reduced returns will depend on the proportion of members in pension mode, and the proportion of the funds committed to Australian Shares.

- **Retired small business owners who invested equity in their companies**

The policy will also impact on small business owners who derive their retirement income from dividends and franking credits on the equity they invested in their unlisted companies (see the Arthur Smith case[ix]). There are around 500,000 incorporated SMEs, although it is difficult to estimate how many will be affected.

Who will not be affected by the denial of cash franking credit refunds?

- Age Pensioners
- SMSFs who had one member in receipt of the Age Pension prior to 28 March 2018
- Retirees in industry funds and some retail funds
- The Future Fund and public sector retirees on generous defined benefit pensions

Is the ALP policy to abolish cash refunds on franking credits really necessary?

2001 saw the introduction of cash franking credits refunds for shareholders who had more franking credits than tax liabilities. The value of franking credits attached to dividends has increased from $31.1 billion in 2005-6 to $47.5 billion 2014-15.

[1] Mean balance for APRA regulated funds 2015-16 males 60-64 $270,710 and females $157,050 (ASFA super statistics September 2018.

[2] There are some large accounts however. In 2016, the ATO reported that 2,184 SMSFs or (0.5%) had balances over $10 million. As each SMSF can have up to 4 members per fund, it is difficult to know how many individual member accounts would be of this size, compared with 994 APRA-regulated fund members accounts with balances of over $10 million. The six SMSFs which have balances over $100 million[2] were described as "accidents of history", often with balances accumulated over 30 years with one or two investments that had done extremely well.

Over the same period the value of cash refunds claimed by taxpayers has grown from $1.9 billion to $5.9 billion[x], driven by an increase in franked dividends paid, personal income tax deductions, and the 2007 Howard government superannuation policy change which made superannuation withdrawals tax free for retirees. Retirees with franking credits from Australian equities that exceed their tax liaibility can be said to have driven some of that growth.

From 2017-18 the introduction of the $1.6 million transfer balance cap and transition to retirement income changes will in many ways unwind the Howard 2006 super policy change, by restricting tax-free income for retirees. Currently around 70%, or $1.8 billion of the $2.6 billion in SMSF franking credit cash refunds accrue to the top 2 deciles who hold balances in excess of $1.5 million. With superannuation tax-free incomes restricted to around $80,000, franking credit cash refunds will drop very significantly.

These super policy changes plus the behavioural response to the ALP policy, wherein older investors substitute other forms of investment for Australian equities or move their superannuation into an APRA-regulated fund will have a substantial impact on the cash refunds claimed by SMSFs. Rice Warner estimates that as much as 25% of Australian Shares held in SMSFs will be sold down, through migration to APRA-regulated funds[xi]. As a consequence, the revenue anticipated by the ALP from this policy measure (which is calculated using 2014-15 data) is very unlikely to eventuate.

AUSTRALIAN RETAIL SHAREHOLDERS [xii]

With the introduction of dividend imputation in 1987 and the removal of the double taxation of dividends, Australian shares have been a preferred savings vehicle for many. Shares have often been acquired as a result of the large-scale demutualisations and privatisations that have occurred over the past 25 years.

Well know stocks such as Telstra, AMP, IAG, BHP and the major banks have been preferred by retail investors, who constitute between 92% to 99% of shareholdings on the registers of these companies. (See table below)

Company Name	Retail Shareholding % register by value	Retail Shareholding % register by number	No. of Retail Shareholders up to 10,000 shares	Record Date
Commonwealth Bank	53%	99%	797,272	31/03/2018
ANZ Bank	42%	97%	505,781	31/03/2018
National Australia Bank	47%	97%	552,245	31/03/2018
Westpac	46%	96%	591,161	31/03/2018
Telstra	20%	92%	1,284,818	2016
Insurance Australia Group	34%	99%	690,297	2017
BHP Billiton	22%	97%	540,248	2017
AMP	27%	99%	740,887	2018

This has been especially true for older Australians who have received little benefit from the Superannuation Guarantee introduced in 1992. As the table below indicates, the median superannuation balance for Australians over 65 years is modest in the extreme, and for those over the age of 70 the median balance in 2014-15 was zero.[xiii] For this cohort, share ownership has been a critical part of retirement planning over past decades. It is this older generation who will feel the most impact, and who in many cases will need to seek income support from the age pension.

Table 2: Median balance by age and gender, 2015-16	
Persons	
15 to 19 years	0
20 to 24 years	2,000
25 to 29 years	13,799
30 to 34 years	27,000
35 to 39 years	40,000
40 to 44 years	50,000
45 to 49 years	63,997
50 to 54 years	66,677
55 to 59 years	77,795
60 to 64 years	68,000
65 to 69 years	*20,000
70 to 74 years	0
75 to 79 years	0
80 to 84 years	0
85 years and over	0
Total	**17,000**
* estimate has a relative standard error of 25% to 50% and should be used with caution	
** estimate has a relative standard error greater than 50% and is considered too unreliable for general use	

Source: Survey of Income and Housing, Australia, 2015–16, Australian Bureau of Statistics

Around 70% of tax-payers over the age of 75 receive franking credits, with an average value of $6,347. (see Table below)

Age	Number of taxpayers	Number receiving franking credits	% receiving credits	Total value of franking credits	Average value of franking credits
Under 18	117,448	6594	5.6	2,418,853	367
18-24	1,554,458	50049	3.2	31,794,715	635
25-29	1,478,576	88,656	6.0	62,889,801	709
30-34	1,468,114	137,228	9.3	166,459,288	1213
35-39	1,304,319	181,259	13.9	313,909,136	1732
40-44	1,366,974	249,274	18.2	604,043,154	2423
45-49	1,281,344	291,315	22.7	879,100,713	3018
50-54	1,268,198	346,531	27.3	1,092,348,645	3152
55-59	1,125,540	361,702	32.1	1,191,686,074	3295
60-64	885,803	337,779	38.1	1,166,176,413	3452
65-69	591,108	283,199	47.9	1,127,091,830	3980
70-74	316,936	167,963	53.0	803,112,142	4781
> 75	454,996	318,256	69.9	2,048,484,147	6437

TAXPAYERS AFFECTED

The Parliamentary Budget Office estimated that over 1.2m Australian taxpayers would be impacted by the ALP policy in May 2018, as follows:

Individual taxpayers:*

Australian government pension and allowance recipients [xiv]	320,000
Not an Australian government pension and allowance recipient	840,000

Superannuation funds directly affected:*

SMSFs in receipt of an Australian government pensions or allowance	20,000
SMSFS [xv]not receiving Australian government pension or allowance	210,000
APRA-regulated super funds	2,300

Total number of citizens affected by removal of imputation credit refunds:	
Member of SMSFs not in receipt of age pension or allowances	420,000
APRA-regulated funds	2,300
Individual tax-payers not in receipt of age pension or allowances	840,000
TOTAL	**1,262,300**

These estimates grossly under-represent the number of Australians affected by the policy. Not included or not fully included in these estimates are the impact of the proposed policy on:

- Australian share-holders on low incomes
- Members of small APRA regulated funds
- Members of large retail APRA-regulated funds
- Retired small business owners who invested equity in their own companies

To identify the full impact of the proposed policy the Parliamentary Budget Office may need to undertake a further review, especially to separate out the small and large APRA funds that are affected and provide more detail on assumed behavioural changes.

Beyond this initial impact on individuals, there are second order considerations such as:

- What is the asset allocation to Australian shares before and after, for each affected group?
- What is the assumed movement in funds between SMSFs, SAFs and large APRA funds as a result of the change?
- Are there assumed changes in franking ratios as a result of change?

IMPACT ON THE AUSTRALIAN CAPITAL MARKET

Reducing the income received from franking credits will encourage retirees to shift away from Australian shares. Other forms of growth assets such as infrastructure trusts, REITS and syndicated property will become more popular and more overseas listed shares will be bought in place of Australian companies.

The policy may also result in a reduction in share buybacks or dividends by Australian companies. Typically, a proportion of the proceeds from a share buyback are deemed to be a return of capital, with the remainder a fully franked dividend. As these dividends will become less attractive under the proposed policy change, Australian companies may reduce share buybacks and instead reinvest in growing their business.

According to Rice Warner, with fully franked dividends less attractive to some Australian investors, these companies may bring forward any buy-back into the 2019 FY. This would remove a significant number of future dividends from the targeted group, further reducing the revenue expected.

A recent Citigroup report explores further the consequence of the ALP policy for Australian equities, anticipating reduced local investor demand for high-dividend shares and potentially cutting the share price of the big banks by 5 to 10 per cent[xvi].

[i] The top 10% of SMSFs received $1.366 bn or 23% of franking credit cash refunds in 2014-15, with an average of around $40,000 per fund, or $20,000 per based on 2014-15 tax returns. Less than 5 (maybe only 1) claimed $2.5m, but this was prior to the $1.6m cap on tax-free pension accounts (PBO May 2018).

[ii] Treasury paper (FOI_2292_-documents_final_redacted.pdf) March 2018, p.3

[iii] ABS December 2017, 6238.0 - Retirement and Retirement Intentions

[iv] Treasury paper (FOI_2292_-documents_final_redacted.pdf) March 2018
v ABS December 2017, 6238.0 - Retirement and Retirement Intentions
[vi] Treasury documents obtained under FOI March 2018.
[vii] Example 2: a retiree couple with no age pension, $800,000 in shares and $75,000 on deposit in bank.

- Investment income $36,000 plus franking credit $15,400 = total income $51,400
  - Without franking credits total income for the couple is $36,000 under new policy

Example 3: A Couple on the full age pension and with $300,000 in APRA regulated superannuation

- Age pension income of around $35,573 + $18,000 in dividends and franking credits = total income of $53,573 – no change under the new policy

viii Simon Benson, Labor's $3.75bn retiree savings grab revealed, The Australian, April 18, 2018
[ix] http://www.fairerretirement.com.au/news/2018/6/26/case-study-small-business-impacted-by-franking-credit-proposal
[x] Of the $5.9 billion, $2.6bn goes to SMSFs, $2.2 bn to individual tax-payers, $0.7 bn to tax exempt entities (the majority of which goes to the Future Fund) and $0.3 bn goes to super funds. (Treasury paper (FOI_2292_-documents_final_redacted.pdf) March 2018, p.5
[xi] http://www.fairerretirement.com.au/news/2018/6/19/research-likely-impact-of-labors-franking-credit-proposal
xii Source Australian Shareholders Association 2018, 6 July
[xiii] ASFA Superannuation Balances By Age And Gender October 2017
xiv Retirees in receipt of Australian government pensions and allowances as at 28 March are exempt from this policy – referred to as the Pensioner Guarantee
xv Given that there is an average of two members in each SMSF, the number of SMSF members affected is approx. 420,000.
[xvi] John Kehoe, Labor election win to hurt high dividend stocks, AFR, Sep 13 2018