Refunding Franking Credits - Let's address the Elephant in the Room – Tax Free Superannuation

Labor party policy is that franking credits should not be refunded to taxpayers and self managed superannuation funds (SMSF) who don't have enough taxable income to pay tax. Note that public superannuation funds that pay tax free pensions will still get their franking credit refunds. The explanation given for removing the refund of franking credits is that people who receive large amounts of income, tax-free from their superannuation fund don't deserve a further handout. But they still will if they can change to holding their shares in a public super fund! They are not giving you the full picture. Franking credits are also refunded to people who do not receive tax-free income from superannuation, and for these people the loss of the refund will reduce their income by up to a third.

The elephant in the room is. If the problem is that people on large tax-free superannuation incomes do not deserve further tax benefits by way of a refund of franking credits, then do something about their tax-free superannuation income. This is much more preferable than hitting those people who do not have the advantage of tax-free superannuation, and are living on an income so low that they do not pay tax.

There seems to be two main arguments for not refunding franking credits, to people whose income is so low that they do not have to pay tax **but** don't qualify for the pension.

1) The need to raise revenue from somewhere; and

2) The concept that it is not fair that people should get a refund of tax when they did not pay it.

In the first point if you need to raise revenue why would you directly target people on an income that has been tested to be so low that they don't even have to pay tax? The second point is totally incorrect because the franking credit is withheld from the shareholder's share of the company profit.

Before you vote to take $10,800 off retirees who only have an income of $36,000 you owe it to them to read this and understand.

Explanation of Franked Dividends Verses Other Investments

If you invest in a property trust, direct property, or just earned interest at the bank, the profits come to you **before** any tax is paid on them. If your investment is not in an Australian tax paying company, then you receive the income before any tax is paid on it. It is the taxing of company profits before they go into the shareholders' hands that is the abnormality here compared with all other types of Australian investments.

If you own 10% of the company you don't get 10% of the profit (that it is decided the company can afford to distribute) you only get 7% with a 3% franking credit. You include the full 10% in your income tax return as taxable income. The 3% is then used either to pay your tax or refunded.

Something similar to when your employer sends part of your wages off to the ATO. You include as taxable income the gross amount using the tax your employer sent off to the ATO to pay your tax or be refunded. It is the same if you do not give your bank your tax file number, the bank withholds half of the interest it pays you but you include the whole 100% of the interest in your tax return and use the amount withheld to pay the tax or it is refunded.

No one says "but oh! If you don't pay tax because you only worked part of the year then you don't deserve to get a refund of the tax withheld by your employer from your pay". Or if you earn so little in interest that you don't have to pay any tax, that the ATO should keep the half of it that has been withheld by the bank.

That is what our stepped tax rate system is about ensuring that the tax you have to pay is determined by your ability to afford to pay it. The exception to this is superannuation where it is taxed at zero or 15% regardless of how high your income is. This is the problem, those wealthy enough to hold their savings in superannuation are not paying their fair share, so the lower tax bracket has to catch more people to raise revenue. Now Shorten is silly enough to be tricked into thinking he is removing that by effectively introducing a flat 30% tax rate for only really low-income earners. Not by the question of whether your income stream is a tax free superannuation pension but by whether it is a dividend paid by an Australian tax paying company. That is right, this problem only effects people who invest in Australian tax paying companies. The share price of these Australian companies will be punished as well, as low income earners are forced to sell their shares to invest elsewhere or lose 30% of the return on their investment.

This sell off of shares in Australian tax paying companies is expected to have such a detrimental effect on their share price that my financial planner has just advised me she wants me to sell out of Australian companies and invest overseas. This is not based on whether I will get a refund of franking credits this is just in anticipation of what this will do to the Australian share market. It will not just be those that need to sell their Australian shares or lose a third of their income, it will also be those getting out of Australian shares, because they fear this mass sell-off will drive down the Australian market.

When I make this move, I will of course have to pay capital gains tax unlike those wealthy individuals who will probably do the same thing before the bottom drops out of the market but once again because their investments are in superannuation they will pay zero or 10% tax on the capital gain.

It has been suggested to me that there are probably not many people that will be caught in this, that is low income retirees with their money in shares that do not qualify for the pension. I think that is a very callus approach, but it is also illogical. You see those on high incomes will not be affected by this at all, and those that have not already retired will be able to transfer their savings into superannuation, so will not be affected by this. It might only be a small number who will not get their franking credits back, but they will be people who cannot return to work to save more to get to an income that they can live on. More importantly if it is so few that will be affected by this, then why introduce the legislation at all? It is not going to raise as much in revenue as they claim, or it is going to be catastrophic to tens thousands of low to middle income retirees. Be very clear on this; it is only going to deny a refund of franking credits to people who have do not have their savings inside of superannuation whose income is so low that their marginal tax rate is below 30%.

Some Numbers to Help Explain
Savings held in Direct Shares:

Unfortunately, it takes a deep understanding of how business profits are taxed to understand why the franking credit belongs to shareholders which is why people are so easily misled.

Nevertheless, it is important to understand this, what is at stake here is 30% of the income of a retired person on just $36,000 a year. The non refund of franking credits will force them to live on just $25,200 and still not qualify for any pension because their assets for the purpose of the asset test will not change and their income is deemed as a percentage of the value of the assets they hold, which has not changed. Further, their taxable income for any other purpose, such as the Medicare Levy will include the value of the franking credits even though they will not receive them.

I accept that people with this amount of savings should not get the pension but I do not accept that they should be subjected to a higher rate of tax as a percentage of their income than those with a higher income than them.

For most of the people affected by this it is too late for them to go back to work. They have just been forced into poverty. Meanwhile people with their savings in superannuation, even over $million will not pay any tax on their income and still receive the benefit of a full refund of their franking credits if they are in a public fund.

Savings Held in Superannuation:

Here is how our superannuation tax concessions work. When you contribute money to superannuation you get a tax deduction for it or your employer takes it out of your before tax dollars. Usually this means you only pay 15% tax on the amount you contribute to superannuation instead of your marginal tax rate. When your concessionally taxed savings earn income it is taxed at 15% or 10% if it is a capital gain, franking credits can be used to pay this tax or refunded to the super fund. Alternatively, when you reach retirement and are over 60, you can take all the money out tax free or switch up to $1.6million into pension phase, where none of its earnings will be taxed in the hands of the fund, or in your hands should you take it out. In fact, it doesn't even go into your tax return, so your income outside of superannuation gets the full benefit of the first $18,200 being tax-free, then a 19% tax rate etc through the thresholds designed to protect people on low incomes, not those with huge tax-free incomes. This is another element of the unfair bit, the tax-free income in superannuation that doesn't even count towards using up your tax-free threshold.

Any further wealth held in superannuation above the $1.6 million remains in accumulation phase so its earnings are taxed at 15% and 10% on capital gains. The earnings on the first $1.6 million would be at least $80,000. If taxed outside of superannuation as normal income it would generate tax of around the same amount as the full age pension**. So paying no tax on the earnings on the first $1.6 million already makes these wealthy individuals a bigger burden to the government purse than an aged pensioner.**
Don't bother using the argument that they should not be penalised for saving for their retirement.

These wealthy people are already costing us the same as a penniless age pensioner who didn't have the big income to be able to get the tax benefits of saving through superannuation. Remember the wealthy here are not only getting a tax benefit better than anyone else when they take their money out of superannuation they also got a tax benefit when they put the money in. Only 15%, while a person earning less than $37,000 a year was paying 19% tax.

Now let's look at the amounts held in superannuation that are in excess of $1.6mil per person. The earnings by millionaires, on this excess will be taxed at an absolute maximum of 15%, and of course franking credits can be used to pay it or refunded if in a public fund. How can that be justified? That people with that much money pay a much lower tax rate than the poor? We have been hoodwinked, and Bill Shorten has proved he does not understand how this works.

Why would you have money outside of superannuation?

Now you would think that the answer is simple: keep your savings in superannuation. You might even smugly think, well bad luck you idiots with shares outside of superannuation, you deserve to be punished for making a bad choice.

One reason that I have noticed is that managed funds seem to outperform superannuation funds. In other words keeping the money outside of superannuation makes sense if you are in a low tax bracket because the after tax return will be better.

Further, there are a lot of restrictions on contributing to superannuation that favour middle age working males. You know the ones with "merit", that vote on this stuff. Once you reach 65 you cannot contribute to superannuation unless you are working. Once you reach 75 you cannot make any superannuation contributions for yourself unless you meet the strict rules in relation to downsizing your home. This prevents people from placing their inheritances or property settlements on divorce into superannuation. This is a problem that is more likely to affect women as they live longer and carers who have given up their careers to care for families or the deceased. If you are earning under $37,000 a year, for example working part time, the most you will pay in tax is 19%. Therefore, even if you could afford it there is far less incentive to put your savings into superannuation than there is for a high-income earner.

Also, people with big responsibilities or surrounded by uncertainty such as dependants with health issues are loathed to put money into superannuation in case, they need it for an emergency before they retire. Even if you are under 65 and trying to save in superannuation as quickly as you can because of an earlier gap in your employment years, there are caps that limit the amount you can put in each year. Thus, favouring the person who has a consistent income through their working life.

The system is so stacked against the average Australian, and such a cash grab for the rich, that it is an embarrassment. Again, if you think that there are not many people that meet the description above, then how can Labor argue that this tax will raise revenue? These are the only type of people that will **not** be able to avoid it.

Conclusion

The system is already very skewed to benefit the wealthy, removing the refund of franking credits allows the wealthy to still use their franking credits to pay their measly 15% tax rate yet hits the disadvantaged with a 30% tax rate.

This information is not getting out there because the demographic it affects cannot get the publicity. Pensioners are fine, young people with plenty of working life left are able to change their savings method to avoid it and the wealthy are fine.

The inequities created by not refunding franking credits were covered in the Campbell Review. This was recognised by the government of the day and corrected. I am not making this up, far better people than me have been before and realised the unfairness. Back in those days you didn't have as much tax-free money in superannuation. That is what has created this problem.

SMSFs will be alright it will not be hard for them to get their franking credits refunded especially now that SMSFs will be allowed 6 members. No problem having your children join up and using the franking credits to pay their contributions tax. If that fails, all they have to do is roll out of the SMSF into a public fund, they can do this at any age because the money is already in superannuation. One way or another they will get their franking credits back. Pensioners will also get their franking credits. People with just a little too much in savings will need to do whatever they can to off load money to qualify for the pension. For more information on this, read this blog https://bantacs.com.au/Jblog/laborslatestantics/ on how burning $2,000 will increase some retirees' income by $9,530 a year.

All that is left to be affected by this supposed solution to all our tax woes are those who have enough income not to qualify for the pension but not enough to have to pay tax, that do not qualify to hold their savings in a superannuation fund. Not only is this an unfair tax it is going to be raising around $10k off a person living on $36k. Those with more income or their savings in superannuation will utilise the franking credit one way or another so I find it hard to believe it will raise much. Certainly not as much as removing some of the tax concessions in superannuation. More importantly, not refunding franking credits it is taxing the wrong people.

Please Bill Shorten don't be sucked in by the wealthy saying look over here look over here. Even the coalition wouldn't dare do this to your electoral base. You have been conned, you should be getting stuck into all that tax free income inside of superannuation; or don't you want to stand up to your industry funds?