Roderick Campbell
PO Box 873
Toowong DC Qld 4066

25 May 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir or Madam

Removal of imputation credits

Some people would like to see the system of dividend imputation credits amended or abolished.

Far from being a rort or a subsidy the imputation system avoids the double taxation of dividends. Without the imputation system a company pays tax and declares a dividend. When the shareholders receive the dividend, the income is taxed a second time.

For someone on a tax rate of 34.5%, without imputation, the effective tax rate on dividend income increases to 54.2%. For someone on the top rate of 49.0%, the effective rate increases to 64.3%. For the millions of Australians accumulating superannuation for their retirement, the effective rate increases from 15.0% to 40.5%. [1]

Some of the likely consequences of such a change are listed below.

- Because the effective tax rates are so high and the after tax returns so low, investors will look for better returns elsewhere. It will be harder for companies to raise capital. Over time the value of shares will fall.

  Peter Swan, Professor of Finance at the University of NSW, estimates that share values will fall by a massive $500 billion if imputation is abandoned. See *The Australian* 6 April 2015 "Investors will be the losers if imputation system goes".

- Superannuation returns will be lower. As a result, fewer people will be able to support themselves in retirement and more people will rely on a government pension.

- The imputation and superannuation systems have turned Australians into a nation of shareholders. Our deep share market allowed companies to raise billions of dollars from their shareholders to reduce the level of debt following the Global Financial

[1] *Right or Rort? Dissecting Australia's Tax Concessions*, Robert Carling, Centre for Independent Studies, April 2015.

Crisis. If we go back to the double taxation of dividends, it will be harder for companies to raise the necessary capital in a future crisis.

- As investors turn from the share market to other investments, companies will find it harder to raise capital. As a result, they will ration their capital more than they do at present. They will do this by only investing in those projects which show the best returns.

  At the moment many companies will invest in projects which show a 12% return after tax. If the double taxation of dividends is re-introduced, those companies will require a 17% return after tax to provide shareholders with returns similar to those earned with the present imputation system. See Table I below.

  Those projects with returns between 12% and 17% represent lost investment, lost employment and, incidentally, lower taxation revenue.

  Because interest on debt is a tax deduction, companies will seek to lower the cut off point for new investment from 17% by taking on more debt. This is precisely what happened before 1987, the year the Hawke government introduced the imputation system. Companies are now more adequately funded with equity capital than they were prior to 1987. As a result, they are less likely to fail during a recession.

Table I

Comparison of Company Rates of Return on an Investment of $29,000
With and without the System of Imputation Credits

	With Imputation	Without Imputation
Company profit before tax	$5,000	$7,143
Company tax @ 30%	$1,500	$2,143
	$3,500	$5,000
Shareholder cash flow:		
Assume company pays 100% as dividends	$3,500	$5,000
Imputation credit	$1,500	$ 0
Taxable income	$5,000	$5,000
Shareholder gross tax @ 49%	$2,450	$2,450
Less imputation credit	$1,500	$ 0
Tax payable	$ 950	$2,450
Shareholder net cash income	$3,500	$5,000
Less: tax payable	$ 950	$2,450
Shareholder cash return	$2,550	$2,550
Company return on investment after tax	$3,500 / $29,000 = 12%	$5,000 / $29,000 = 17.2%

Note: It is assumed the shareholder is on a marginal tax rate of 49%

- The re-introduction of the double taxation of dividends will especially affect private companies. Most private companies are not able to raise capital from their shareholders. The usual pattern is for these, largely, family companies to pay low dividends and to reinvest the rest of the after-tax profits in the business. Over time these companies build up a large store of franking credits which are invaluable in the event of a death in the family or a hand over from one generation to the next.

  To illustrate in the case of a death, a special dividend with fully franked credits attached can be paid to the remaining shareholders who then have the cash to buy the shares from the estate of the member who died. Without the benefit of the imputation system many private company shareholders will be forced to sell out, often leading to the loss of the energy and dedication which families bring to an enterprise.

  In seeking to repair the budget deficit or to fund a lower company tax rate, it is important not to lose sight of the benefits of the imputation system. These are significant.

  Yours faithfully

  R C Campbell