AUSTRALIAN LISTED INVESTMENT COMPANIES ASSOCIATION

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Tax White Paper Task Force
The Treasury
Langton Crescent ACT 2600

via electronic submission

Dear Sir/Madam,

Submission to the March 2015 Tax Discussion Paper
RE: Dividend Imputation & CGT Discount

The Australian Listed Investment Companies Association ("ALICA") is the industry body representing many of Australia's traditional Listed Investment Companies ("LIC").

As traditional LICs, ALICA's members adopt a consistent 'buy and hold' approach to investments with the objective of deriving dividend income for on-payment to their shareholders. Combined, ALICA's 7 members have in excess of 200,000 shareholders and more than $13 billion invested in predominantly Australian listed companies and trusts.

The shareholder base of ALICA's members is predominantly Australian retail shareholders, self-managed superannuation funds, charitable and not for profit organisations.

Through their investment in LICs these shareholders provide capital to many Australian corporates, both large and small. The consistent fully franked dividends they receive from their investments in the LICs are a critical factor in their investment decisions.

The Discussion paper asked four questions that are particularly relevant to the LICs and their shareholders:

20. To what extent does the dividend imputation system impact savings decisions?
25. Is the dividend imputation system continuing to serve Australia well as our economy becomes increasingly open? Could the taxation of dividends be improved?
26. To what extent would Australia benefit from the mutual recognition of imputation credits between Australia and New Zealand?
19. To what extent is the rationale for the CGT discount, and the size of the discount, still appropriate?

We will seek to provide our views in two parts – on the imputation system and more briefly on the CGT discount.

Imputation System

The current dividend imputation system has two major characteristics:

a) It prevents the double taxation of corporate profits in the hands of investors
b) It ensures that these profits are taxed at the marginal rate of Australian taxpayers as part of Australia's progressive income tax policies.

The imputation system has been beneficial to the Australian economy, Australian capital markets, savers and investors, retirees, government revenue, and has improved corporate capital management.

Imputation has led to more disciplined capital management by Australian corporations who are now accustomed to seeking to invest in Australia, paying their fair share of Australian Tax, resisting over gearing, and returning a higher level of franked dividends to shareholders.

In turn, shareholders have demonstrated the ability to save well from these dividends and support corporate rights issues, dividend reinvestment and share purchase plans, newly floated enterprises, and government privatisations (for example the recent strong support for Medibank Private). Strong support for Australian shares was also evident in recapitalisations during the GFC.

Without dividend imputation this strong support by Australian shareholders for equity raisings, which support economic growth, would convert to a demand for more corporate debt issuance, increasing the gearing (and risk) of corporates – Australia's debt to equity ratio (excl. financials) is 62% compared to a global average of 74% (82% in the US).

Imputation means that Australian shareholders prefer to have Australian corporates paying Australian corporate tax and then distributing those earnings, and there is some incentive for companies to reduce taxable income offshore in favour of more taxable income onshore. Australia's pay-out ratio for the last 10 years has been 65%, compared with 43% in the UK and 34% in the US. The % of franked income has slightly increased (77% compared to 75% in 2001) despite growth in offshore revenue. As much of these earnings distributed as dividends are taxed at the top marginal rate, the government collects taxation on income that may otherwise have not been distributed were Australian corporates to seek more offshore income or retain more of their earnings to fund future growth.

Imputation has encouraged a high level of share ownership in Australia. In the most recently published survey of share ownership by the ASX (2012 Share Ownership Study) it was noted that 6.7 million Australians, or 38% of the adult population participated in the Australian share market (including self managed super funds but excluding industry and retail funds). Reimposition of double taxation would affect all of these. Comparable rates of share ownership elsewhere are: Germany 15%, UK 17%, and Switzerland 21%. (Figures available for other jurisdictions include all retirement funds).

Removal of imputation would lead to immediate and lasting falls in the share market as the current Australian levels reduce to an OECD average. Research indicates that 74% of the imputation credit is included in stock valuations. Superannuation funds (not included in the above %) would also reduce their Australian corporate holdings. In 2010 the RBA estimated that retail shareholders owned 33% of financial stocks on the ASX.

In our view introduction of mutual recognition of imputation credits between Australia and New Zealand should only be considered if it did not compromise the Australian imputation system.

Further, if the refundability of franking credits were removed the impact would hit superannuation funds, pensioners, and charities and anybody paying less than 30% tax (22% of households with income below $50,000 were invested directly in shares in 2012). By reducing the net income of these taxpayers, they are likely to call upon increased government support. Franking credits add 1.4% to an average 4.3% cash dividend, so the removal of imputation would slash investors' income by around 25% assuming pay-outs remain constant.

Therefore, in our view were double taxation to be reintroduced corporate Australia may be less inclined to invest and pay tax in Australia, and savers would be pushed more towards investing in housing, debt instruments, and international investments, with associated lower returns and foreign exchange risk. Reliance on Government support would increase. The depth of the Australian capital markets would be significantly impacted and not offset by secure increases in international capital flows. The long term effect on capital formation in Australia would be significant.

The current imputation system is well understood by our investors, is regarded as simple, is less complex than many of the alternatives in other jurisdictions and has served the investor community, retirees and the capital markets well since its introduction. Any moves to reduce its effectiveness would have a disastrous effect on those who rely on income from their investments, and raise their reliance on Government sources.

<u>CGT Discount</u>

Capital gains are traditionally taxed differently from other forms of income.

This allows for the effects of inflation and the time value of money and for the risk element in investing.

Both of these reasons remain valid for Australian investors

Compared to the previously used indexation methodology, which is still available for assets purchased between 1985 and 1999, the CGT discount is simple to use and to understand, reducing the complexity of investment decisions for many Australian investors.

It should also be noted that the current discussion is being held in the context of low inflation rates. A sustained period of higher inflation would reduce the attractiveness to an investor of the 50% CGT discount in favour of an indexation methodology and a return to such a methodology in these circumstances would reduce government revenue

Yours sincerely,

F Gooch

Frank Gooch
Chairman