

## The Dividend Imputation system and proposals for change

### Background

- Prior to 1987, income generated by Australian companies was effectively taxed twice. Companies were taxed on the income they generated. And when companies distributed profits to shareholders, the dividends were taxed in the hands of investors.
- In 1987 the Labor Government sought to end this double taxation by introducing a system of **dividend imputation**. The Australian Taxation Office (ATO) says *"This is where the tax the company pays is imputed, or attributed, to the shareholders. The tax paid by the company is allocated to shareholders as franking credits attached to the dividends they receive."*
- Investors are required to inform the ATO of both the franked amount and the franking credit. The ATO says it uses this information to:
  - *"reduce your tax liability from all forms of income (not just dividends) and from your taxable net capital gain"*
  - *refund any excess franking to you after any income tax and Medicare levy liabilities have been met."*
- The ATO has a useful 24-page document entitled **"You and Your Shares 2018"** that describes in detail how taxation is applied to shares.
- The publication can be found here:

<https://www.ato.gov.au/uploadedFiles/Content/IND/Downloads/You-and-your-shares-2018.pdf>

### Franked and unfranked dividends

- The ATO notes *"Dividends can be fully franked (meaning that the whole amount of the dividend carries a franking credit) or partly franked (meaning that the dividend has a franked amount and an unfranked amount)."*
- Essentially, a franked dividend is generated when a company has already paid the tax on the income. And when a company distributes income to shareholders that it hasn't paid tax on, an unfranked dividend is generated.

### A franked dividend can reduce the taxpayer's tax liability.

- The ATO provides an example in the *"You and Your Shares 2018"*.
- In the example, John receives a fully franked dividend of \$700 and the unfranked dividend of \$200 from an Australian company. It is assumed that John has other income of \$80,000. The Medicare levy is not included in the calculation.

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**John's tax return (extract)**

| Tax return item                            | Value (\$)    |
|--|---------------|
| Unfranked dividend received                | 200           |
| Franked dividend received                  | 700           |
| Franking credit, non-cash                  | 300           |
| Other assessable income                    | 80,000        |
| <b>Total taxable income</b>                | <b>81,200</b> |
| Tax on \$81,200, assessed at 2017–18 rates | 17,937        |
| less franking tax offset                   | 300           |
| <b>Tax payable*</b>                        | <b>17,637</b> |

\* This does not include any liability for the Medicare levy.

Source: Australian Taxation Office, "You and Your Shares 2018" page 6.

<https://www.ato.gov.au/uploadedFiles/Content/IND/Downloads/You-and-your-shares-2018.pdf>

**Refund of excess franking credits**

- Also as noted above the dividend information can also determine whether a refund of excess franking credits is available.
- In terms of a refund of any excess franking credits, the ATO sets out a number of requirements. Those requirements can be found here:

<https://www.ato.gov.au/individuals/investing/in-detail/investing-in-shares/refunding-franking-credits---individuals/?anchor=eligibilityforarefund#eligibilityforarefund>

- A key requirement is that the basic tax liability is less than your franking credits, after taking into account any other tax offsets.
- The ATO publication "You and Your Shares 2018" has an example showing how a refund of excess franking credits is applied.

**John's tax return (extract)**

| Tax return item                            | Value (\$) |
|--|------------|
| Tax payable on taxable income              | 2,000      |
| less Other tax offsets                     | 1,500      |
| <b>Net tax payable</b>                     | <b>500</b> |
| plus Medicare levy                         | 200        |
| <b>Sub-total</b>                           | <b>700</b> |
| less franking tax offset                   | 1,000      |
| <b>Refund (of excess franking credits)</b> | <b>300</b> |

(Amounts are for illustrative purposes only.)

Source: Australian Taxation Office, "You and Your Shares 2018" page 7.

<https://www.ato.gov.au/uploadedFiles/Content/IND/Downloads/You-and-your-shares-2018.pdf>

- The publication "You and Your Shares 2018" goes into more detail about the entitlement to a franking tax offset such as how long the shares have been held or how tax is applied in the case of Partnerships or trusts.

**Refunds of franking credits when you don't need to lodge a tax return**

- But what if you don't need to lodge a tax return?
- The ATO publication "Refund of franking credits instructions and application for individuals 2018" details what happens in this case.

- The publication can be found here:

<https://www.ato.gov.au/uploadedFiles/Content/IND/downloads/Refund-of-franking-credits-instructions-and-application-for-individuals-2018.pdf>

- The publication provides a worked example. But essentially it describes a situation where an individual who wasn't required to lodge a tax return in the year may still be entitled to a refund of franking credits received.

### **Labor Party policy: A fairer tax system: Dividend imputation reform**

- The Federal Labor Party have advocated measures to reform the dividend imputation system from July 1 2019.

- The details can be found here:

<https://www.chrisbowen.net/issues/labors-dividend-imputation-policy/>

- And a more detailed 5-page factsheet can be found here:

<https://www.chrisbowen.net/media/183744/180604-updated-factsheet-dividend-imputation.pdf>

- The proposal will extend the system where imputation credits can be used to reduce tax, but will end the system where excess dividend imputation credits can be used for cash refunds.

### **Pensioners would be exempt from the policy on cash refunds**

- The opposition Labor Party says that pensioners will be exempt from the policy to end cash refunds on excess imputation credits.
- *"Every recipient of an Australian Government pension or allowance with individual shareholdings will still be able to benefit from cash refunds. This includes individuals receiving the Age Pension, Disability Support Pension, Carer Payment, Parenting Payment, Newstart and Sickness Allowance.*
- *Self-managed Superannuation Funds with at least one recipient of an Australian Government pension or allowance as at 28 March 2018 will be exempt from the changes."*
- The opposition Labor Party expect the measure to improve the budget position by \$5.2 billion in 2020/21 and \$5.5 billion in 2021/22.

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