The Australia Institute

Research that matters.

Background briefing on franking credits

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About TAI

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals, memberships and commissioned research. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

Our purpose—'Research that matters'

The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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Introduction

The detail of tax is a lot like superannuation. It's complicated and most people think it's boring. It is because of this that some people are able to arrange their tax affairs in order to minimise the amount of tax they pay. It is important that people think it's boring because then they will pay little attention to it.

As the recent senate enquiry into multinational corporations profit shifting shows you don't want the public to get a glimpse of what is going on. They may get upset and start demanding that their elected representatives do something about it. This is particularly the case when the government is claiming it needs to cut spending on services at the same time that large profitable companies are avoiding paying tens of billions in tax.

Franking credits are worth about $30 billion per year in Australia. About $10 billion go to households and another $10 billion go to superannuation funds, trusts and charities. The remaining $10 billion go to other Australian companies.

Of the $10 billion of franking credits that go to households, the overwhelming majority flow to high income households with 75 per cent going to the top 10 per cent of households by income. 50 per cent of householders receive less than 5 per cent of franking credits.

Treasury in the recent tax discussion paper questioned the usefulness of the franking credit system in Australia. It suggested that scrapping the franking credit system could help pay for a cut in the corporate tax rate.

What are franking credits?

The way in which Australia deals with franking credits is based strongly on theory, but at the same time it is a system that the rest of the world has rejected. Its good theoretical underpinnings combined with its obscurity helps explain why it has survived for so long.

Franking credits are a way to deal with concern that dividends from businesses are not taxed twice. So when a company earns a profit it is taxed at 30 per cent after deductions. But dividends paid out to shareholders turn into income for those shareholders. Income is subject to income tax and so the dividends are taxed again according to the 'double taxation' view.

To avoid this double taxation the tax office allows businesses who have already paid tax on their dividends to also create franking credits. This is basically a note that comes with the dividend that says this income has already been taxed at 30 per cent. Shareholders when they do their tax receive a credit for the income deemed to have been paid on their behalf by the company.

International comparisons

Of the 34 OECD nations Australia is one of only four nations that calculate franking credits in this way. About 24 other OECD nations have hybrid franking credit systems that return some of the corporate tax paid on the dividends to the shareholder. 6 OECD nations return no corporate tax paid on dividends to shareholders.

Australia goes further and provides a refund of any unused franking credits. If the shareholder pays no tax, such as a superannuation fund for over 60s in the pension phase or someone who has reduced their taxable income below the tax free threshold, then the tax office will pay out the value of the franking credit to the shareholder. Of all the OECD nations' only Australia is that generous.

Distribution of franking credits

The international evidence shows that Australia is extremely generous when it comes to franking credits. But which are Australians is the government being generous to? NATSEM have modelled for The Australia Institute the amount and distribution of franking credits.

Franking credits to households (excluding franking credits earned in superannuation funds and trusts) are worth almost $10 billion per year. They flow overwhelmingly to high income earning households as table 1 below shows.

Table 1 – Income distribution of franking credits

Decile	Franking credits received by households ($m)	Proportion of total households
1	$59	0.6%
2	$105	1.1%
3	$28	0.3%
4	$71	0.7%
5	$192	1.9%
6	$266	2.7%
7	$296	3.0%
8	$593	6.0%
9	$913	9.2%
10	$7,404	74.6%
Total	$9,926	100.0

Source: STINMOD 2014-15 Financial year estimate

The Australian Tax Office statistics show more detail of very high income earners. The ATO statistics reports those who receive franking credits on an individual basis. This is different from the above NATSEM modelling that works on a household basis.

Table 2 shows very high income earners and the proportion of franking credits they receive. It shows that people earning more than a million dollars a year receive 17 per cent of franking credits and about half of all franking credits go to those who earn more than $180,000 a year.

Table 2 – Very high income earners proportion of franking credits

Incomes above	Proportion of taxpayers	Proportion of franking credits
$1,000,000	0.08%	17.1%
$500,000	0.3%	27.2%
$250,000	1.3%	42.2%
$180,000	2.2%	48.8%

Source: ATO tax statistics

The NATSEM modelling also looked at the age distribution of franking credits. This shows that franking credits increase with age, peaking for people in their 50s. The fall off after that probably relates to people moving into retirement and primarily earning an income from their superannuation funds (which are not included in the NATSEM modelling).

Table 3 – Age distribution of franking credits

Age group	Franking credits received ($m)	Proportion of total households
Less than 30	$230	2.3%
30-34	$323	3.2%
35-39	$886	8.9%
40-44	$1,387	14.0%
45-49	$1,184	11.9%
50-54	$2,383	24.0%
55-59	$1,348	13.6%
60-64	$650	6.6%
65-69	$407	4.1%
70-74	$459	4.6%
75 plus	$670	6.8%

Source: STINMOD 2014-15 Financial year estimate

Refunding unused franking credits

As noted above only Australia refunds unused franking credits. Treasury estimates that this refund is worth $4.6 billion each year. The then Treasurer Peter Costello introduced refunds for unused franking credits in 2000.

Refunding unused franking credits means that some Australians pay negative tax. That is they pay no tax but then get a refund from the Australian Tax Office. These unused franking credits would be particularly valuable to retired people over 60 who are drawing an income from their super. Their super fund pays no tax on its income regardless of how much income they draw and so any franked dividend would be additional income from the tax office. Generally the super pension received by the retiree is also tax free.

This also means that $4.6 billion of corporate tax is refunded. That is businesses paying dividends to Australians who pay no tax are effectively not paying any tax on those dividends and instead receive a cash bonus for receiving dividends.