Australian Institute for Progress

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ALP Franking Credit Policy is Taxation Theft

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The Australian Institute for Progress exists to advance the discussion, development and implementation of public policy for Australia's future, from its base in Brisbane. The future does not look after itself.

ALP Franking Credit Policy is Taxation Theft

Summary

Labor's franking credits policy abolishes the tax free threshold for a certain class of low income earners and sets the minimum tax rate at 30%. This is discriminatory and unjust and undermines Australia's progressive taxation system.

Major findings are:

- The policy affects anyone earning below $37,000 who owns Australian shares and receives dividend income.
- Labor's policy will disproportionately affect low income Australians who have any sort of share portfolio will be affected. They may be caring for a spouse or child, suffering illness or disability, be temporarily unemployed, studying or a multitude of other things and so be unable to earn income to offset the franking credit.
- It establishes a flat tax rate of 30% for share investors from $0 to $37,000 without a tax free threshold.
- This is the highest rate of marginal tax for low income earners in the OECD.
- A share investor receiving only grossed-up dividends of $37,000 will pay approximately the same tax as a wage earner with an income of $61,000.
- Share investors are differentially affected, depending on what percentage of their income is derived from shares. In one case we highlight the share investor pays tax equivalent to 4 times the other person, despite their income being equal. This means tax is being levied on the basis of how you earn income, not how much income you earn.
- The current policy is not a "gift" or a "rort" to shareholders, but Labor's policy would be a gift - to the tax office - and a proposed rort - by a new government.
- It undermines Australia's progressive tax system. Transfers under our tax and welfare systems are one of the reasons why inequality in Australia has been contained.

Analysis

Labor claims that refunding dividend franking credits to low income earners is a "gift" and a "rort", but as our very simple model shows, abolishing it enriches the Australian Taxation Office, and puts low income earners at an unfair disadvantage.

They are forced to pay up to 30 cents in the dollar more tax on their income than they should under their marginal tax rate.

According to OECD statistics this is the highest rate of income tax levied on personal income. Next highest is Belgium on 25% but Belgium does have a personal tax allowance of $6,137.37, which has the same effect as a tax free threshold[i]. Australia has a progressive tax system, which it is justifiably proud of, which ensures that the lowest income earners pay no tax at all. It is one of the secrets to our relatively equal society. [ii]

The real marginal tax rate becomes 30% for those earning less than $18,200, and also for those earning between $18,201 and $37,000. This is only slightly less than the 32.5% marginal tax paid by those earning between $37,001 and $90,000.

We model five different scenarios of a hypothetical company that earns $200 per share and distributes 50% of its income in dividends. We then look at the effective tax rate paid by investors owning one share each in each of the 5 tax bands. We then calculate how much money the ATO retains for taxpayers in each of those bands.

	Income Band				
	$0-$18,200	$18,201-$37,000	$37,001-$90,000	$90,001-$180,000	%180,001+
	Marginal tax rate				
	0%	19%	33%	37%	45%
Company income per share	200	200	200	200	200
Company tax	60	60	60	60	60
Net Income	140	140	140	140	140
Available for investment	70	70	70	70	70
Available for dividends	70	70	70	70	70
Franking Credit	30	30	30	30	30
Grossed-up income	100	100	100	100	100
Notional tax at marginal rate	0	19	33	37	45
Additional tax paid	30	11	0	0	0
Total tax paid (Coy plus personal)	30	30	33	37	45
Real tax rate	30.0%	30.0%	32.5%	37.0%	45.0%
Payout ratio	50%				

Table 1: Effect at the marginal rate of ALP franking credit proposals

Out of the $100 distributed in dividends, the ATO gets to keep $30 from the low income investors, which is between $30 and $11 more than their marginal tax rate, depending on whether they earn less or more than $18,200. This is a windfall for the tax department.

If the money is rebated to the low-income earner, then the normal marginal tax relativities are re-established.

The graph below shows the real marginal tax rate for dividend paying shares versus the marginal tax rate that applies to everything else.

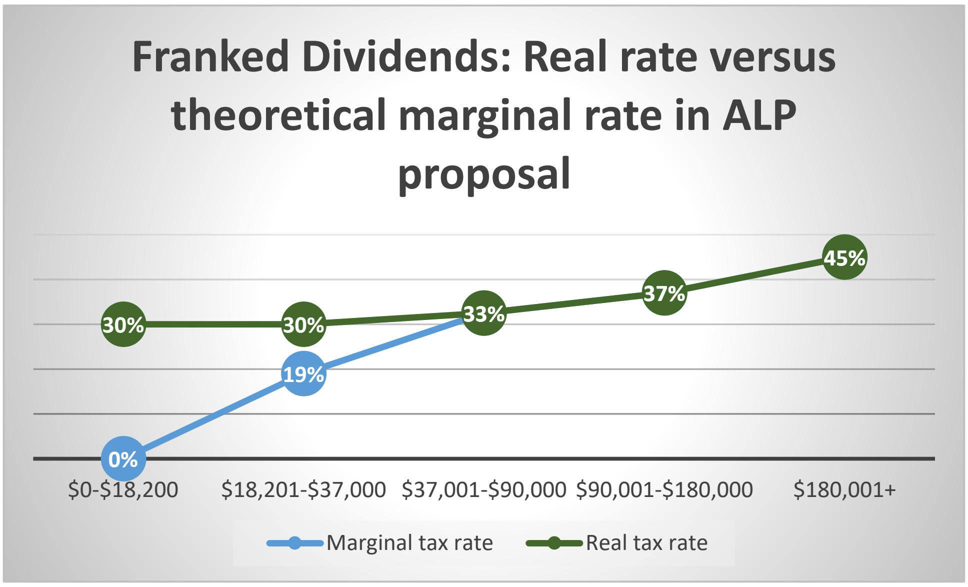

Figure 1: Graph of tax effect of ALP franking credit proposal versus tax situation now.

The blue line shows what a good progressive tax system looks like with a steep upwards curve. The green line shows a tax system which is much flatter.

The policy unjustifiably taxes people on the lowest incomes who hold shares that will pay them franked dividends. Their low incomes mean they will be retirees, invalids, or have foregone regular work for some other reason like caring for a sick relative or spouse, or raising children.

This is illustrated graphically below. The thrifty investor will always pay more tax than the wage earner at the same level of income in the sum of $7,538. What's more at $37,000 they will pay the same tax as the wage earner will at approximately $61,000 pa after they have received $24,000 pa more of income.

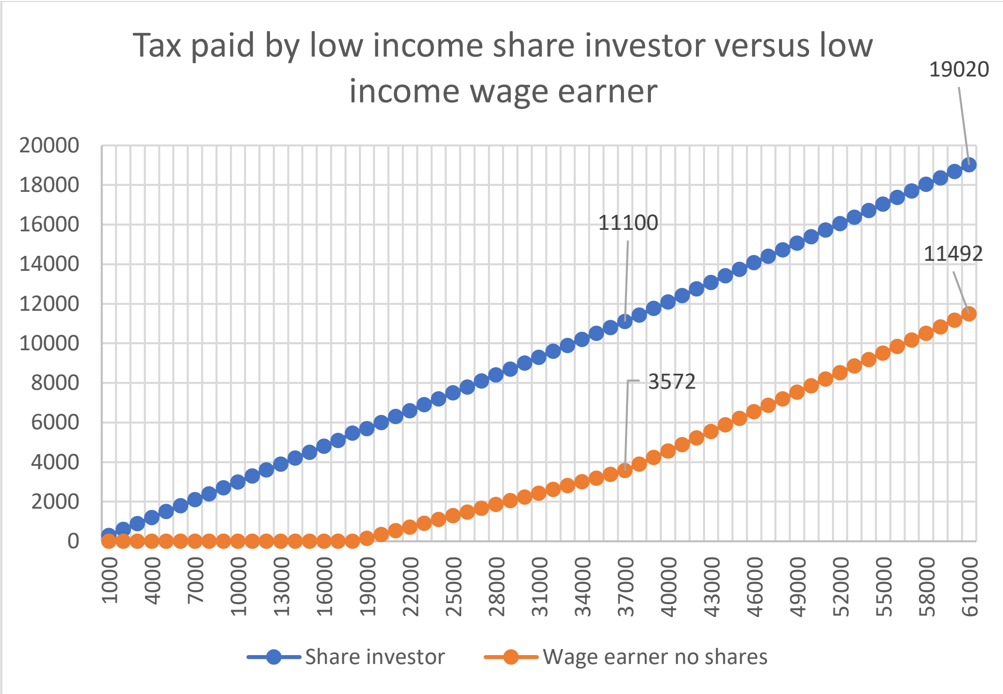

Figure 2: Tax paid by share investors versus wage earners.

We also modelled the difference between two older Australians. One with a grossed-up dividend income of $37,000 pa, which takes them up to the threshold of the 33% marginal tax rate. The other with dividends of $18,200, taking them to the threshold of the 19% marginal tax rate, with earnings from other sources, say Uber, of $18,800 taking them up to the $37,000 pa figure.

For the same gross income, the share investor pays 4 times as much tax. So Australian tax is being determined on the basis of what your occupation is, not how much you earn. This is a new front in identity politics!

	Share investor $	**Share investor/ uber driver $**
Grossed-up fully franked dividends	37000	18200
Uber salary net operating expenses		18800
Income for tax purposes	37000	37000
Tax paid shares	11100	5460
Income tax before franking	3572	3572
Franking credit available	11100	5460
Franking credit used	3572	3572
Excess tax paid	7528	1888

Australians who rely on franking credits have been portrayed as wealthy, but it should be noted that a parcel of Commonwealth Bank Shares worth 438,983.10 would provide a grossed-up dividend of $37,000 as of 12:31 on May 15, 2019, and a smaller parcel worth $215,932.20 a grossed-up dividend of $18,200. Many Australians have superannuation balances of these amounts, and virtually all live in a house worth more than this, on average. These are not large sums.

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[i] https://stats.oecd.org/index.aspx?DataSetCode=TABLE_I1 Accessed May 14, 2019.

[ii] Rising inequality? A stocktake of the evidence Productivity Commission Research Paper. August, 2018