

# A change for the better?

Director of Flor-Hanly, Tony Olsen, details the dividend imputation system and Labor's proposed reforms, which would undo the current system.

There has been a lot of publicity regarding Labor's proposal to make the tax system fairer by closing down a concession that gives cash refunds for excess dividend imputation credits.

Australia's dividend imputation system was introduced by Paul Keating to eliminate double taxation of dividends paid from company profits to shareholders. Under that system, shareholders could use imputation credits to reduce their overall tax liability. However, if their imputation credits were more than their tax liability, the excess was lost. This policy change by Paul Keating was a massive step forward.

The Howard and Costello government introduced the refund of those excess credits to the taxpayer to make the system fairer which resulted in them getting a refund from the ATO. The Labor Government is proposing undoing this. They believe this concession is costing the federal government more than \$5 billion each year.

**The following simplistic example shows how the current system works:**

- Bill earns \$30,000 interest in his own name. He has no other income
- Ben is the sole shareholder in a company. That company earns \$30,000 interest. The company pays tax at 30% ie \$9,000 and pays Ben a dividend of \$21,000

**BILL'S TAXATION POSITION WOULD BE AS FOLLOWS:**

- Taxable Income – interest \$30,000
- Tax payable on \$30,000 (approximately) \$2,242
- Bill's after tax dollars: \$27,758

**BEN'S TAXATION POSITION WOULD BE AS FOLLOWS:**

**Ben's Company**

- Taxable Income – Interest \$30,000
- Company Tax payable \$9,000
- Company's after tax dollars paid to Ben as a dividend would be \$21,000

**Ben**

- Dividend from company \$21,000
- Add Imputation Credit of \$9,000
- Ben's Taxable Income \$30,000
- Tax payable on \$30,000 will equal approximately \$2,242

- Less tax paid by the company (imputation credits) \$9,000
- Ben gets a refund of \$6,758
- Ben's after tax dollars equals the dividend of \$21,000
- Plus the tax refund of \$6,758
- Ben's after tax dollars would be \$27,758

The source of Bill and Ben's income is the same, ie \$30,000 of interest. The only difference is Ben's income was earned inside a company. Currently they would both end up with the same after tax dollars.

**Let's now consider what would happen under Labor's proposed changes to stop the refund of excess imputation credits:**

**BILL'S TAXATION POSITION WILL NOT CHANGE**

- He will have after tax dollars of \$27,758

**BEN'S TAXATION POSITION WOULD BE AS FOLLOWS:**

**Ben's Company**

- Taxable Income – Interest \$30,000
- Company Tax payable \$9,000
- Company's after tax dollars paid to Ben as a dividend would be \$21,000



**"What did you do with your tax refund?"**

**"You're looking at it."**

**Ben**

- Dividend from company would be \$21,000
- Add Imputation Credit of \$9,000
- Ben's Taxable Income \$30,000
- Tax payable on \$30,000 will equal approximately \$2,242
- Less Tax paid by the company (imputation credits) \$9,000
- Ben does not get a refund but doesn't have to pay any tax because the imputation credits cover it
- Ben's after tax dollars equals the dividend of \$21,000

**BEN IS \$6,758 WORSE OFF THAN BILL ON THE SAME ORIGINAL INCOME OF \$30,000 OF INTEREST**

Labor recognises that a lot of pensioners are struggling with the cost of living and some of them rely on refunds of excess imputation credits. They plan to allow such pensioners to continue to get refunds of excess imputation credits.

Superannuation funds have low tax rates and the refund of imputation credits currently ensures the tax rate payable on the source income is at superannuation tax rate.

The proposed changes by Labor would result in a superannuation

fund with 100% invested in company shares paying close to 30% tax instead of 15% on its source income.

Superfunds who have a spread of investments will be able to use the imputation credits to pay for the tax on the other sources of income.

Most people have superannuation and will be indirectly affected.

Will the proposed changes result in a fairer tax system? That will probably depend on your political views and where you hold your investments!

**DISCLAIMER**

Tony Olsen is a Director of Flor-Hanly, Commercial and Agribusiness Accountants. Tony can be contacted on 4963 4800.

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