Welcome to our latest e-newsletter.
With a Federal Election to be called next year, and a Labor victory looking increasingly likely after recent Coalition instability, we thought it would be worth taking a look at one of Labor's more divisive proposals - abolishing refunds of dividend imputation credits for those with no tax to pay. We look at why it's yet another regrettable shift in the superannuation goalposts for those planning for retirement. We also look at how fast-tracking the company tax rate cuts may actually cost small business more in tax, and also detail our Christmas closing times for this year.

In this edition...

Retirement goals harder to hit with Labor's proposed franking credit changes

This year Labor signalled its intention to provide some serious differentiation at the next Federal election by announcing that if elected, it would seek to abolish franking credit refunds for those with no tax to pay. For superannuation and retirement planning, the effect of this proposal could be significant.

The Labor opposition had already made some waves with its announcement last year that it would begin taxing distributions to trust beneficiaries at a minimum rate of 30%. That is, the first dollar of any trust distribution would be taxed at 30% in the hands of a beneficiary, rather than being subject to lower personal rates (including the tax-free threshold). 'Trust distributions' may seem to many like a murky tax-dodge used by the super-rich, but the reality is that average small-medium business owners are those most likely to be adversely affected by this measure.

Labor then proceeded to double down on this new direction by announcing its plan to stop excess imputation credits being refunded to individuals and super funds.

The Dividend Imputation system was introduced back in 1987. The intention was (and remains) effectively to prevent the double-taxation of company tax profits - once on the profit of the company, and again in the hands of shareholders when that profit is distributed as dividends. There are other flow-on benefits for the wider economy (for example, providing an incentive to keep investment capital in Australia), but that is the underlying rationale.

The system works by passing on imputation (or franking) credits to shareholders when dividends are paid, in most cases equivalent to the amount of tax that has already been paid by the company on the income. Dividends are taxable in the hands of shareholders, but because the company has already been taxed on the income, the tax that the shareholder pays is reduced by the amount of the franking credit.

But what happens when the shareholder has no tax to pay? There are a number of ways this might happen, but one of the more common would be where a shareholder is drawing a tax-free pension from superannuation. Any dividends received by the taxpayer in this situation would be subject to the tax-free threshold (as well as any other applicable offsets) before any tax is due. So in effect, there may be no tax to reduce by the value of the franking credit.

When the system was first introduced, any excess franking credits were simply lost. Whatever tax there was to pay was reduced by the value of the credit, but if there was anything left over, it was forfeited. On first glance, this may seem tough but on further consideration makes some sense. The intention is to avoid double taxation rather than providing an additional tax refund. If the shareholder pays no tax, then tax is still paid only once (by the company).

But during the mining-boom-fuelled prosperity of the early 2000s, the Coalition changed the rules so that these excess credits could be refunded. Not only could taxpayers have their tax bill reduced to zero by franking credits, but now if there was anything left over, a refund would be receivable.

Fast forward to 2018 and successive Federal Budgets have been mired in years of deficits. In one sense, repealing this generous concession should be a relatively easy sell in this climate. In its current form, the policy is expected to save $10.7 billion in its first two years and $55.7 billion over the next decade. One estimate suggests that up to 86% of the cost will be borne by the wealthiest 10% of Australians, so the argument is that the majority of Australians will be unaffected. Plus, it's not a new measure, but rather a return to the original intent of the system. How bad could it be?

The problem once again is the perpetually moving goalposts, particularly with respect to retirement planning. While not a direct attack on superannuation, self-managed superannuation funds are a major beneficiary of the current system because of their lower tax rate, and this is especially so once the income of the fund becomes tax-free (when pensions commence). Retirement strategies have been planned, often years in advance, and then commenced based on certain assumptions as to how much a person will need to live on and what income will be available. Franking credit refunds may have been factored into these calculations for close to two decades.

Not long after the announcement, the inevitable response from the Government focused on the impact it would have on retirees, and in particular pensioners. In response, the opposition very quickly announced modifications to exempt anyone on a Government aged pension, or an SMSF where a member is currently receiving an aged pension. Note the word 'currently' there - the date of effect is 28th March 2018. Where a superannuation fund member starts receiving an aged pension after that date, the fund will still lose access to franking credit refunds.

This was an attempt to hose down the ideological concerns raised by the Government, and did indeed allow Labor to regain some momentum. For retirees either side of the cut-off for receiving a part pension though, it's conceivable that a person who does not get a Government pension could be worse off in total than someone else who is receiving Government benefits, however small, due to lost franking credits. This could easily total many thousands of dollars in lost income, brought about by being a few dollars shy of an eligibility threshold. This again undermines the goal of superannuation.

Despite Labor's continued insistence that wealthy Australians are the group most likely to be impacted by this measure, the truth is far less certain. Because of the significant reforms to super introduced by the Coalition last year, those in the retirement phase who have millions put away in superannuation are now taxed on earnings from balances that exceed $1.6 million. This new tax payable will be available to offset imputation credits against. In addition, wealthier individuals often have other sources of taxable income, aside from tax-free superannuation pensions, and tax on this income can be likewise offset by franking credits. In contrast, middle income taxpayers, and especially those in business, are more likely to be entirely dependent on a tax free pension from super, and in such situations franking credit refunds may form a significant component of a modest retirement income.

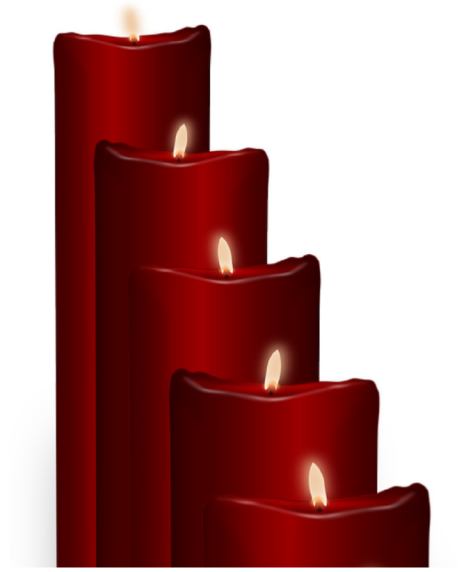
It's no wonder newly elected independent member for Wentworth Kerryn Phelps has called for a 5 year freeze on superannuation changes. Years and years of superannuation changes like this proposal, some of them significant enough to fundamentally alter retirement plans decades in the making, erode certainty and confidence in the system and will ultimately lead to a higher spend on Government pensions. Ostensibly, most people like the idea of a balanced Budget - as long as the savings don't come from 'my' pocket. This proposal is a return to the original intention of the dividend imputation system, rather than an 'unfair' new measure, and is estimated to save the Budget billions. However, both sides of the political spectrum must begin to get more creative and implement broader repair and reform measures, rather than returning over and over again to the seemingly limitless well of superannuation, lest an already shaky system be completely destabilised by ongoing uncertainty.

It's important to remember of course that right now, this is just a proposal for future legislation. Not only is Labor in opposition, but even if, as current polls seem to indicate, it is elected to Government, recent history suggests it may have a difficult time getting any revenue measures unchanged through both houses of Parliament.

Fast-tracked company tax cuts could hurt business owners

In a classic case of "beware of Governments bearing gifts" (if that's a thing), the Coalition's recent announcement **that it will seek to accelerate tax cuts for companies turning over less than $50 million per annum may actually end up costing business owners more in tax.**

We've previously highlighted the fact that cuts in the company tax rate are of marginal benefit to small business owners who take profits out the



Christmas closure times

As another year draws to a close, we'd like to take this opportunity to wish you and your family a Merry Christmas and a happy New Year.

We love to help our clients achieve great outcomes. Thank you for trusting us to work with you over this last year. We consider it a privilege, and look forward to continuing the journey with you next year and beyond.

Office hours

Once again we'll be closing our office for a couple of weeks to give our team a chance to relax and enjoy a well-earned break. We often find that our clients want the same thing business as dividends. But the Government's current program of tax cuts has actually been set up in such a way that it could well cost small businesses that retain profits more in tax! This is because of a strange anomaly in the legislation which requires the rate of imputation credits to be passed on at the current rate of company tax, not the rate that the profits were originally taxed at. So even if prior year profit was taxed at a higher rate, franking credits can only be paid out at the new, lower rate. The difference in the two rates is lost, and this is an actual cost to the business owner. It's effectively a tax increase!

If the company tax rate stays the same for a number of years, eventually the impact of this anomaly will be watered down as more profit is retained, and franking credits for tax paid are accrued at the new rate. But if the Government proceeds with a faster schedule of incremental reductions, there will be a franking credit hit equal to the amount of the tax cut every time the company tax rate is reduced.

Though this may sound complex, the important take away is this - **there is significant potential for the proposed company tax rates cuts to cost small business owners more in tax**.

Labor have indicated their support for the acceleration of the cuts, which makes the proposal more likely to succeed. For those with more complex arrangements, there may still be some options to reduce the

for themselves at this time, but please feel free to contact us if you need assistance with anything.

The office will be closed from 1pm Friday 21st December 2018, and will reopen again in the new year on Monday morning, 7th January 2019.

During this time you can still call and leave a message, and we'll ensure someone gets back to you as soon as possible. We'll also leave a mobile phone number on our voice mail so that you can contact someone immediately for more urgent matters. We'll be checking our emails and faxes, and documents can be left in the locked drop box on the west-facing wall next to reception.

Who we're supporting this year

As is our tradition, in lieu of Christmas cards this year we'll be making a donation to charity. This year we're once again supporting the fantastic work of Auscam Freedom Project, an Australian organisation that provides early intervention support to young girls in Cambodia, to keep them in school and protect them from the risks of trafficking. Since being founded in 2013, AusCam Freedom Project has provided 198 school scholarships and helped over 2,500 girls with life skills training and mentorship.

If you'd like to help by providing a gift bag of clothes, stationery and backpack to a young girl in Phnom Penh, you can donate to the AusCam Christmas Campaign.

impact. It will make getting the right
advice more important than ever.