Budget hit by super fund tax credit grab

Katie Walsh

The number of franking credits claimed by superannuation funds soared by more than two-thirds in a year, costing the federal government billions in forgone tax.

Experts say the situation will get worse for the budget as the $1.4 trillion super industry grows and more people begin receiving a pension stream, when most earnings aren't taxed.

"There's a real cost to Treasury as more and more funds go into pension mode," said Institute of Public Accountants senior tax adviser **Tony Greco**.

Super funds booked just under $4.2 billion of refundable franking credits in 2010-11, up 75 per cent from $2.4 billion the previous year and the highest on record, according to the latest figures available. For self-managed super funds, the figure was $3 billion, up from $1.8 billion.

Super funds, including self-managed funds, pay a 15 per cent tax rate, half that of companies. Like individuals, they can use the credits from the extra 15 per cent of company tax paid to offset other income or, if there is none, usually get a refund cheque.

"That's why there are good advantages for having high-dividend-paying shares; that's why for some people it's all that they do because they know that it writes off their tax bill," Mr Greco said.

The credits are more attractive when investors turn 60 and start receiving a pension from their super fund. At that point, most earnings don't have to pay tax. From next July, a 15 per cent tax on earnings above $100,000 will apply.

Many investment companies have mandates requiring them to invest only in companies that are fully franked. This often excludes listed companies like QBE with foreign operations that generate profits that aren't fully franked.

Some super investors chase share buybacks, which generally comprise a capital and dividend component. ANZ's recently announced $425-million buyback is an example.

"If they're in pension mode, it's a wonderful way to get some money back because they get credits," Mr Greco said. As more funds start paying pensions, the bigger the hit to government revenue, he said.

CPA Australia head of policy **Paul Drum** said the benefit to super funds was one reason why Australia could not get rid of its imputation system, despite being one of only two countries left with one.

"There's a generation of self-funded retirees relying on franking credits," he said. "They go dividend shopping at interim dividends time and annual reporting time.

"If taken away, it would put even more pressure on a flagging system."

Mr Drum said the imputation system should be included in a review of national retirement savings.

SMSF Professionals' Association of Australia technical and policy senior manager **Jordan George** said investing in Australian companies paying fully franked dividends was a popular strategy for SMSFs, but the tax advantage was only one driver.

Capital growth, familiarity and ease of access to the direct investment were others. Popularity within portfolios was consistently around the 30 per cent mark, he said. Attractiveness was greater in the search for yield when interest rates were low, he said.

University of Melbourne professor and tax expert **John Freebairn** said the credits should be refundable given the difference in tax rates.

"You want to make it neutral for the super fund to invest – they want to pay the same tax whether they buy debt or equity or property or infrastructure. The company tax rate is essentially a 30 per cent down payment," he said.