**SMSF Owners' Alliance**
Limited ABN 96 161 052 464
Not-for-profit public company

## Getting rid of imputation to reduce company tax is a bad idea

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In the lead-up to the Budget, all sorts of ideas for tax reform will be floated. Some will have merit, others won't.

The suggestion by the Australian Industry Group to withdraw dividend imputation to pay for a lower company tax rate is one without merit.

Of course Australia's corporate tax rate of 30% should be lower to compete for investment with other countries, particularly in Asia.

But lowering the company tax rate to 20% whilst dropping imputation as proposed by AIG will immediately drop the value of Australian companies to their Australian shareholders by 20%! It would knock the market for six at a time when it is already reeling.

This simple table shows how a shareholder on a marginal tax rate of 37% (or any other marginal rate) would get a 20% lower return, therefore reducing the value of the company's shares to investors by 20%.

| | 30% company tax rate with Imputation | 20% company tax rate without imputation | |
|---|---|---|---|
| Company profit | $100 | $100 | |
| Company tax | $30 | $20 | |
| Dividend paid | $70 | $80 | |
| Imputation credit | $30 | $0 | |
| Total shareholder taxable income | $100 | $80 | |
| Tax paid by shareholder@37% marginal rate | $37 | $29.6 | |
| Net return | $63 | $50.4 | |
| Loss in investment return | | $12.6 | 20% |
| **Therefore drop in value of company share to investor** | | | **20%** |

On the example above, the investor's effective tax rate is increased from 37% to 49.6%.

Imputation is not a tax concession. It is a credit to shareholders for tax on company profits that has already been paid. Without imputation, returns on investment would be double taxed, first via the corporate tax on profits and then on dividends issued to shareholders.

This credit is only available to Australian taxpayers. So removing imputation would disadvantage Australians who invest in Australian companies and the lower tax rate gives an advantage to foreign investors. This does not have political appeal.

Another bad outcome of removing imputation would be to distort the balance between equity and debt in corporate capital raising.

Imputation puts equity on the same effective tax basis as debt. Without full imputation, debt finance will be relatively cheaper, inevitably leading to greater use of debt funding and an increase in corporate gearing with consequent increase in risk.

Removing or reducing the imputation credit would distort and devastate the Australian equity market. The impact on an already depressed and nervous market would be catastrophic.

SMSF Owners supports constructive change to the taxation system in accord with the Government's objective to make the tax system work better and foster economic growth. Dropping imputation to fund a cut in the company tax rate is not the way to achieve this goal.

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