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canberra times: q&a

Q 1: Could you please explain the advantages of franking credits? I gather that, in preparing a tax return, they are added to total dividends and so would be taxed at one's marginal rate before finally being deducted from the total assessed tax liability for the year. Is this correct and, if so, why do they provide the big tax advantage claimed for them?

Withheld, Canberra

A 1: The Australian Taxation Office (ATO) website explains imputation credits as:

'Dividends paid to shareholders by Australian resident companies are taxed under a system known as imputation. It is called an imputation system because the tax the company pays is imputed, or attributed, to the shareholders. The tax paid by the company is allocated to shareholders by franking credits attached to the dividends they receive.'

'You include an amount equal to the franking credit attached to your dividend in your assessable income. You are also entitled to a franking tax offset equal to the amounts included in your income.'

Note there are some exceptions to this rule under Anti Avoidance rules which includes the holding period rule and the related payments rule. See the ATO website for more detail on these rules, however, for most investors these anti avoidance rules do not come into play.

The ATO website further states 'The franking tax offset will cover, or partly cover, the tax payable on the dividends. If the tax offset is more than the tax payable on the dividends, the excess tax offset will be applied to cover, or partly cover, any tax payable on other taxable income you received. If any excess tax offset amount is left over after that, we will refund that amount to you.'

Subject to satisfying anti-avoidance rules, resident individuals are eligible for a refund of excess franking credits if:

- they receive franked dividends, either directly or through a trust or partnership, and
- their basic tax liability is less than their franking credits after taking into account any other tax offsets they are entitled to.

As the current tax rate for companies is 30%, the real benefits of imputation credits come where an investor's marginal rate of tax is below 30% - for example for resident individuals earning under $37,000 pa (19% tax marginal tax rate or even nil when under $18,200 pa) or for superannuation funds (tax rate of 15%).

A simple example - $1,000 dividend payment received. If fully franked would come with a $428 imputation credit. This is the 30% company tax amount on taxable income of $1,428. If you have total assessable income of less than $18,200 for the financial year then you would have no tax to pay on this dividend payment and a tax refund of $428 would be received as an excess tax offset.

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