Argo Investing in Australia
Argo Global Listed Infrastructure

Argo Investments Limited
ABN 35 007 519 520

Argo Global Listed Infrastructure Limited
ABN 23 604 986 914

Head Office
GPO Box 2692
Adelaide, South Australia 5001
Level 12, 19 Grenfell Street,
Adelaide, South Australia 5000

Telephone (08) 8210 9500
Facsimile (08) 8212 1658
Email invest@argoinvestments.com.au

Sydney Office
Level 37, 259 George Street,
Sydney, New South Wales 2000

Telephone (02) 8274 4700
Facsimile (02) 8274 4777

www.argoinvestments.com.au
www.argoinfrastructure.com.au

19 October 2018

Committee Secretary
Standing Committee on Economics
PO Box 6021
Canberra ACT 2600

By email: economics.reps@aph.gov.au

Inquiry into the implications of removing refundable franking credits

Dear Sir/Madam,

We respectfully make this submission to the Standing Committee on Economics.

WHO WE REPRESENT

This submission is made on behalf of the shareholders of Argo Investments Limited (Argo) and Argo Global Listed Infrastructure Limited (AGLI). Both companies are managed by Argo's executive staff but are separate in all other respects.

Argo

Argo is one of Australia's oldest and largest listed investment companies (LICs) with approximately $5.7 billion in assets under management. Our portfolio is invested predominantly in the shares of companies listed on the ASX. Our dividends are fully franked and provide a growing income stream to more than 85,000 shareholders.

Our share register is comprised almost entirely of retail shareholders, including around one third being self-managed superannuation funds (SMSFs). The majority of our shareholders have modest investments in Argo, with 63% holding parcels of 5,000 or fewer shares, ie less than $40,000 worth at current prices.

AGLI

AGLI is a LIC which floated on the ASX in July 2015. It has approximately $310 million in assets under management which is invested in a portfolio of global listed infrastructure stocks. It aims to provide a total return for long-term investors consisting of capital growth and dividend income, and to provide diversification benefits for Australian investors.

Our share register is comprised almost entirely of retail shareholders, including around one half being self-managed superannuation funds (SMSFs). The majority of our shareholders have modest investments in AGLI, with 68% holding parcels of 10,000 or fewer shares, ie less than $20,000 worth at current prices.

INTRODUCTION

When companies pay tax on their income, Australia's current dividend imputation system rightfully recognises that tax has already been paid on those profits. When a company's profit is distributed to its shareholders (ie owners) in the form of dividends, the company can attach franking credits. These franking credits should have the same value to all Australian tax payers, regardless of their marginal tax rate. By removing the refundability of franking credits for shareholders who have a marginal tax rate of zero percent, it implies that they have paid no tax. This is incorrect. The company in which they are a shareholder has already paid tax on the dividend income on the shareholders' behalf.

The removal of refundable franking credits would have a fundamentally inequitable impact by unfairly and disproportionately impacting individual and SMSF investors. We believe it would have a particularly deleterious effect on low and middle-income earners. For those Australian shareholders reliant on the income from their refundable franking credits, the abolition of refundable franking credits would amount to an immediate 30% tax increase.

ADDRESSING THE INQUIRY'S TERMS OF REFERENCE

Who receives refundable franking credits, what opportunities does this provide and what is the impact on income for Australians?

Many of our shareholders receive refunded franking credits. In particular, low and middle-income shareholders and SMSF members rely heavily on them. The imputation system has attracted many smaller investors to Australian shares to provide a means for lower to middle-income earners to boost their annual returns to help maintain an adequate living standard. The loss of these refunds would have a greater proportional impact on these smaller shareholders than higher income earners who may be in a better position to restructure their investments.

Many of our smaller shareholders are not high-income earners and invest outside of superannuation. For these individuals, their income would be reduced by up to 30% if they do not meet one of the exemption criteria. This is a significant drop in income for those who can least afford it.

We believe that refundable franking credits are an important component of the overall return for Australian shares. The existing system boosts retirees' income and underpins the demand for Australian shares. When investment returns are low, a higher percentage of superannuation funds would miss out on some or all of their franking credits, exacerbating low investment returns.

How do refundable franking credits support tax principles, tax neutrality and fairness?

Refundable franking credits are, in our view, fundamental to the principles of tax neutrality and fairness.

The refund of excess franking credits allows for equal tax treatment for those earning their income from investments as for those earning income from personal exertion. A worker has pay-as-you-go tax deducted from wages and then is entitled to a refund at the end of the tax year if excess tax has been deducted. Similarly, a company pays tax on behalf of its shareholders before they receive their dividends, with the prepayment reflected by the attached franking credits, so the shareholder should be entitled to a refund if excess tax has been paid on their behalf.

Shareholders have expressed concern and even anger over the apparent exclusions to the policy (whether actual or effective) for what they regard as favoured organisations – larger industry and retail super funds, public sector superannuation entities etc. Should such exclusions exist, then the policy appears unfairly targeted at those who lack sufficient political pressure to gain similar exemptions.

Additionally, this is not actually a return to the former 'classic' imputation system as has been promoted, as the policy's application is highly selective, with other exemptions including for charities, universities and possibly the Future Fund.

Many of our shareholders therefore see this proposal as an attack on the self-managed superfund sector in particular, which is inequitable and unfair on Australians who have taken responsibility for self-funding their retirement.

Who would the removable of refundable franking credits impact and what would be the expected behavioural changes by investors?

The removal of refundable franking credits would largely impact the smaller SMSFs and the lower to middle-income tax payers, particularly in a proportionate sense, relative to their total income.

The larger super funds and wealthier individuals will often be able to restructure their investments to make use of franking credits to offset other taxes, although this will have implications for the Australian share market as they seek to rebalance portfolios.

We believe that many individuals will seek to ensure that their assets are below the level that would entitle them to a part-pension, perhaps by moving shares from a SMSF into their own hands (in pension paying phase they would not be subject to CGT) and obtain both a part-pension and franking credits.

It is likely that other financial engineering opportunities will emerge, not all of which may be ultimately for the benefit of the individual investor. In addition, when advice is sought by less experienced investors, we may again see the potential for exploitation by some advisers who see an opportunity for additional fees.

Individuals are being encouraged by this proposal not only to reduce investment levels where it makes economic sense for them to do so, but will be actively encouraged away from investing in and providing equity capital to Australian corporates, toward higher yielding off-shore investments and/or lower growth investments that are not subject to the franking 'withholding' tax.

Due to anticipated and unanticipated behavioural changes, there is considerable doubt that these proposals will raise the revenue forecast.

We would argue that Government policy should be to encourage individuals to save for their retirement, to continue to build those savings and to invest in Australian companies – this proposal is counter to all of those objectives.

UNFAIR IMPACT ON LICs

Although this submission is primarily on behalf of our shareholders, there are also competitive implications for Argo's business as a listed investment company.

The proposal would unfairly disadvantage shareholders of LICs as compared to other investment vehicles such as unit trusts. This is because income received via a trust is taxed only in the hands of the recipient and income received via a LIC is subject to tax before it is distributed to shareholders as dividends. However, the current dividend imputation system ensures that company owners are not adversely affected when dividends received are taxed again in the recipient's hands. The abolition of franking credit refunds will disadvantage those investors whose marginal tax rates are lower than the company tax rate.

Investors will therefore be penalised for using a LIC structure by losing or receiving a diminished value of their franking credits. This would amount to a tax on investing through a company structure and would impact competitive neutrality.

CONCLUSION

Based on the volume and tone of the correspondence we have received from our shareholders, we believe the ALP's proposed policy is causing considerable anguish and concern amongst those most likely to be affected. Many of our shareholders are confronting the prospect of their modest incomes being substantially reduced and, as such, significantly impacting their standard of living.

We therefore strongly recommend that Australia's existing dividend imputation system be maintained.

Yours sincerely,

Tim Binks
Chief Operating Officer & Company Secretary