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Labor's Franking Credit Policy

An analysys by *Natasha Fenech of Super Concepts*

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We've had quite a lot of queries from clients about the announced policy of Labor should they win the next Federal election. This article was published by Natasha Fenech of Super Concepts. It is not a political statement from Lifestyle Wealth Partners, as we have seen in many articles with political overtones, which we have not forwarded. This article does have some elements of a political commentary however, is less strident than some other articles on the same subject. We regard this as a reasonable assessment of the issue and potential problems this policy may create for our clients.

The element of this policy that we at Lifestyle Wealth Partners cannot comprehend is the damage it will do to every day Australians who are trying to provide for themselves in retirement. We have yet to see any analysis showing how the "super rich" are going to be penalised except by a small amount in superannuation. Given an overwhelming majority of the wealth owned by very rich Australians is outside superannuation we cannot see how this policy hits them very hard if at all!

Further this policy favours union based industry funds but hits self managed funds and makes the playing field uneven. It simply places burden fairly and squarely on regular Australians who have ambitions to make their lives better and we at Lifestyle Wealth Partners struggle to find any equity in this policy.

Natasha's analysis assumes a heavy exposure to Australian dividend paying shares, and a total exposure greater than what most of our portfolios hold. Please keep in mind that this may overstate the long term impact of your personal portfolio. If you have any questions or would like further information the please contact us.

Please also remember that this is presently policy by Labor and Bill Shorten, it is NOT the law as it stands as at the date of this blog.

New modelling reveals impact of Labor's franking credit policy

Natasha Fenech, 21 November 2018

A detailed analysis of Labor's proposal to remove franking credit refunds has identified the pension incomes that will be hit hardest by the policy.

The Australian Labor Party's proposal to remove franking credit refunds is part of a suite of projected $55 billion savings earmarked for important services and infrastructure projects. The underpinning philosophy is that these savings will be provided by Australia's wealthiest people who won't miss it.

But is that really the case?

The SuperConcepts technical team has done a detailed analysis and projection of the pension incomes hit hardest by Labor's proposed policy.

Retirees with an account-based pension receiving a minimum pension amount of $45,000 per annum at age 65 will find themselves 15 per cent worse off in retirement savings after 20 years.

This is hardly the high-net-worth individuals that an aspiring Labor government suggested were the primary target of the projected government revenue.

Naturally, this concerned us at SuperConcepts, and the data we revealed formed a crucial pillar in our submission to the inquiry on the issue with the standing committee on economics.

Our analysis looked at the impact of removing refundable franking credits over 20 years on the superannuation balance of a member who at age 65 had an SMSF balance equivalent to the average SMSF balance for a member of that age (i.e. $900,000).

The calculations assume a 40 per cent allocation to Australian shares, 3 per cent capital growth and a 4 per cent income return. The calculations also assume the SMSF has a single member who only has a retirement phase interest in the fund and is receiving the minimum annual pension entitlement from an account-based pension.

Closing balance after 20 years with refundable franking credit: ***$953,480***

Closing balance after 20 years without refundable franking credit: ***$825,519***

That's a significant impact on the fund's earning rate and the total income received each year.

Breaking it down on an annual basis helps put the household budget in perspective.

Year one total income with franking credits: ***$36,771***

Year one total income without franking credits: ***$30,600***

That's the cost of running a car and a modest annual holiday.

From there it gets worse. After five years, the income differential is $7,631 per annum, and after 10 years, the differential is $9,207 per annum.

The effect on the annual pension entitlement is just as worrying. After 10 years, the SMSF member's minimum annual pension entitlement would be reduced from $60,756 to $56,762.

After 20 years, from $88,298 to $76,991.

This is due to the retirement phase benefit being replenished at a lower rate as pension payments are made, resulting in a quicker depletion of their superannuation assets

Sure, trustees could increase their pension payments above the annual minimum requirement, but this would accelerate the depletion of their capital and increase their dependency on the age pension at an earlier age.

The introduction of the superannuation reforms on 1 July 2017 means that SMSF members with substantial balances are less likely to be impacted by the removal of refundable franking credits.

The $1.6 million transfer balance cap introduced on 1 July 2017 effectively limits the amount of franking credits which are refundable under the current regime.

SMSF members, who before 1 July 2017 had pension balances in excess of $1.6 million, were required to withdraw any excess pension balance above $1.6 million or transfer the excess balance to an accumulation interest in the fund.

As investment earnings from assets supporting an accumulation interest are taxable, the existence of an accumulation interest results in the fund having some taxable income to use its franking credits rather than those credits being refunded, which may have been the case prior to the 2017-18 income year.

This is an important point because it means SMSF members with a total superannuation balance in excess of the general transfer balance cap (currently $1.6 million) may not be impacted, or the impact from removing refundable franking credits will be much less than first anticipated.

In other words, the projected budget savings of $55 billion over 10 years is unlikely to be realized. And much of the revenue that will be raised will come from the superannuation accounts of members with much smaller superannuation balances. Surely, that's not the intention of the workers party.

If this policy is well-intentioned, the execution is misguided. A rethink in conjunction with the SMSF sector is in order to get the balance right. That, or a total abandonment of a muddled policy that hits the lower end of retirees.

By Natasha Fenech, chief executive, SuperConcepts