Philanthropy and the Franking Credit Debate

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While it's increasingly accepted that charity and philanthropy are not the same thing, there is also growing awareness of the complex policy issues involved in these areas.

One such example is the public fracas on the proposed changes to Australia's dividend imputation system, also known as "refundable franking credits", and what such changes would mean for the future of Australian philanthropy.

The changes will, in the main, affect investors who rely on franking credits to bolster returns from their Australian share holdings – most vocally, self-funded retirees. The proposal is dubbed a "retirement tax" in Liberal circles and an "inheritance tax" by those advocating Labor's reforms.

Self-funded retirees make up a large portion of Australia's donors to charitable causes and are our future founders of charitable trusts. Herein sits the intersection of external taxation pressures and internal community and philanthropic needs.

On this, Jeff Kennett believes that with philanthropic generosity forming an important cornerstone of Australian life, "governments do not have the capacity to replace either the financial or compassionate aspects of philanthropic acts. Put at risk the capacity for giving and you risk hurting the most vulnerable aspects of Australian life, be they human or the pillars underlying our cosmopolitan society."

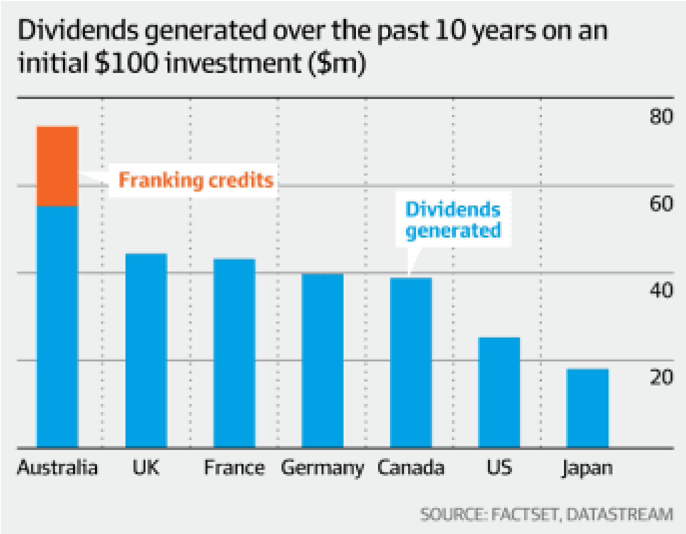
The fracas arose when Labor announced its policy to retain the structure of the franking credit system but remove the cash refund of excess franking credits.

In 2000, reforms were introduced by the then Liberal Coalition to enable shareholders to effectively "cash out" their imputation credits. This benefited investors with lower taxable incomes (usually retirees) and charitable and deductible-gift-recipient organisations which were tax-exempt.

Franking credits have formed a central part of Australia's successful listed markets trajectory and help to explain why Australia's real economy is the only OECD economy to avoid a cyclical recession since September 1991.

Double tax problem

Solving for the challenges of double tax imputation, then Treasurer Paul Keating introduced in 1987 the world's first franking credits regime, which lead the world at the time and prompted sharemarket-savvy economies such as Hong Kong and the United Kingdom to follow the Australian model.



But 20 years on, Australia and New Zealand are the only two OECD countries to operate dividend imputation systems. The United Kingdom (1999), Germany (2001), Finland (2005) and Norway (2006) abandoned this shareholder-level tax relief, simply because of the complicating nature of contemporary sharemarket distributions.

The original challenge remains – ensuring that corporate profits being distributed through dividends to shareholders face only one layer of tax, equal to the marginal tax rate of the shareholder.

Tabitha Lovett, CEO of the Besen Family Foundation, believes "the retention of franking credits is enormously important to charities and those they assist". She adds: "They significantly increase the funds distributed each year to charitable causes for the public benefit. The philanthropy sector has advocated consistently and vocally against any changes being made to the dividend imputation system and arguably has been heard given the Opposition has confirmed that philanthropic trusts and foundations would be exempt from the changes they are proposing."

The ATO reports that between 2001-02 and 2016-17, refundable franking credits provided a cumulative total of more than $8.3 billion to philanthropic trusts, foundations and other charities.

In 2016-17, the value of refundable franking credits claimed was just over $1.1 billion dollars.

In 2015, the Turnbull government undertook a review of the broader tax system and, understandably, the charity and philanthropy sectors rallied to dissuade any changes that would affect refundable franking credits.

It appears today that Labor has a policy of ending the availability of refundable franking credits and has made its proposed changes to refundable franking credits a 2019 election issue.

Exemptions

But it has confirmed the policy will not apply to income-tax-exempt charities and deductible-gift recipients. Perhaps this time Labor noted the influence of the charity sector and philanthropists and the emotive response that would ensue if it was seen to reduce the amount of private funds being distributed via philanthropy for the public benefit.

This means that philanthropic trusts and foundations would be exempt from the changes and would continue to be able to access refundable franking credits.

Supporters of the reforms say higher tax revenue equips government to better meet public demand for vital services such as health, education, public transport and infrastructure.

Opponents counter that the community and the economy are weakened when you disincentivise individuals from saving, attack their ability to be independent and to provide for their families and future generations and to voluntarily give to good causes through discretionary giving, which ultimately distinguishes philanthropy from that of charity.

Every step should be taken to promote private society's ability to champion philanthropy and leave Australians to solve the challenges of our times.

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