



# Guide To...

## Dividend imputation

The dividend imputation system was introduced on 1 July 1987 to prevent investors from having to suffer tax twice on dividends received from companies. Before its introduction, tax was paid by the company on its profits. This aspect has not changed. Previously however, when the profits were later distributed to the shareholder, the dividends were fully taxable again in the hands of the investor. Dividend imputation seeks to rectify this anomaly.

### How Does It Work?

Under the dividend imputation system, no tax will be payable by a shareholder on dividends received from a company, to the extent that the dividend is franked. The corporate tax rate is currently 30%.

When you receive a dividend, it will be either franked, partially franked or unfranked. “Franked” simply means that there is a tax credit attached to the dividend, representing the amount of tax that the company has already paid. The shareholder is then entitled to a tax offset, which is generally equal to the amount of the franking credit. The dividend imputation system works as follows:

1. A company earns taxable income in the amount of \$100. The company pays income tax of \$30, leaving \$70 net income available for distribution.
2. A shareholder receives a franked dividend from the company of \$70, with an attached \$30 franking credit.
3. The shareholder must include both the \$70 (franked dividend) and the \$30 (imputation credit) in his/ her assessable income. This is known as “grossing up”. A tax offset of \$30 is then available to the shareholder.
4. The effect of the offset is that, if the shareholder’s tax rate is less than 30%, no tax will be paid on the dividend and the investor may receive a tax refund on the balance of the unused franking credit. If the individual’s tax rate is above 30%, tax will be paid, but only on the difference between the individual’s marginal tax rate and the corporate tax rate (30%).

### Example 1:

Mrs. A’s position:

Dividend received from XYZ Co	\$ 70
Plus: Imputation gross-up	<u>\$ 30</u>
Taxable income on dividend	\$100

Income tax @45% on grossed up dividend	\$ 45
Less: Rebate in relation to the franking credit	<u>\$ 30</u>
Income tax payable by Mrs A on the dividend	\$ 15

## **What About Excess Credits?**

For shareholders taxable at rates lower than the company tax rate, so that the franking rebate exceeds the tax payable on the dividend, the “excess” franking credit can be used to offset tax payable on other income. This can include capital gains, income from employment or from other investments and the Medicare levy. A refund of franking credits in excess of those required to offset any other taxation liability can, in certain circumstances, be claimed from the Australian Taxation Office.

### **Example 2:**

Mrs. B's position	
Dividend received from XYZ Co	\$ 70
Plus: Imputation gross-up	<u>\$ 30</u>
Taxable income on dividend	\$100
Income tax @ 15% on grossed up dividend	\$ 15
Rebate in relation to the franking credit	<u>\$ 30</u>
Excess franking credit	\$ 15

The excess franking credit (\$15) can be used to reduce tax payable by Mrs. B on other income. A refund of the excess franking credits can be claimed if Mrs. B does not have other taxable income.

## **Holding Period Rule**

If you acquired shares or interest in shares on or after 1 July 1997, it will be necessary for you to hold the shares or interest in the shares (at risk) for a continuous period of not less than 45 days before you can obtain the benefit of franking credits received during that period. This is known as the “holding period rule”. For preference shares, the holding period is 90 days. The holding period rule will not be applicable to small shareholders who elect to claim a franking rebate ceiling of \$5000 per year.

If you sell or dispose of shares (acquired on or after 1 July 1997) during the holding period, the franking credits in respect of that particular share will be lost.

Investments in derivatives have a longer holding period calculated in accordance with a formula. Your financial planning consultant will be able to explain to you how you will be affected by the holding period rule and dividend imputation.

*If you have any queries in relation to the content of this material, please do not hesitate to contact Kate Kimmorley the Principal Financial Adviser at Kimmorley Financial Management on (07) 5591 1725.*

---

The advice contained herein does not take into account any persons particular objectives, needs or financial situation. Before making a decision regarding the acquisition or disposal of a Financial Product persons should assess whether the advice is appropriate to their objectives, needs or financial situation.

Persons may wish to make this assessment themselves or seek the help of an adviser. No responsibility is taken for persons acting on the information provided. Persons doing so, do so at their own risk. Before acquiring a financial product a person should obtain a Product Disclosure Statement (PDS) relating to that product and consider the contents of the PDS before making a decision about whether to acquire the product.

Kate Kimmorley and The Kimmorley Corporation Pty Ltd ABN 52 076 011 571 trading as Kimmorley Financial Management are authorised representatives of GWM Adviser Services Limited ABN 96 002 071 749, registered office 105 - 153 Miller Street North Sydney NSW 2060, is an Australian Financial Services Licensee and member of the National Group of companies.