

Preparing for the Demise of Franking Refunds

24 September 2018 | Daryl Wilson & Greg Lander, Affluence Funds Management

Much has been written about the plan by the Federal opposition (likely to be the next Government) to abolish franking credit refunds. Along with removing negative gearing for existing housing and a 30% minimum tax rate on family trust distributions, this amounts to a three-pronged attack on Australian investors. The stated targets are wealthy Australians. But the impact will be felt by a much wider group of middle Australia, including millions of retirees.

If you're likely to be affected by the loss of refundable franking credits, here's what you can do about it.

Make your voice heard.

If you're impacted enough to care, then you need to act now. The best chance to stop this is before the next election. We think there's a good chance that the proposed changes will be wound back or scrapped altogether if those who will be affected speak up. Here are three ways you can provide feedback to our politicians.

1. Sign the online petitions from Wilson and Plato.

Both fund managers have started petitions. You can access the Plato Investment Management petition [here](#). The Wilson Asset Management petition is [here](#). Each takes no more than one minute of your time to complete. Do it right now.

2. Write, or speak to your local member

Personal examples can have an impact on local members. If you're faced with the loss of thousands of dollars of franking credit refunds, and that makes up an important part of your retirement income, let your local member know. It's very hard for them to ignore issues which directly and meaningfully impact their constituents.

3. Make a submission to the house economics committee.

On 19 September, the Treasurer, Josh Frydenberg asked the House Standing Committee on Economics to inquire into the implications of removing refundable franking credits. If you're really keen, you can find the link to make a submission and guidelines on how to do it [here](#). If you don't want to make a submission yourself, you may be able to contribute to the efforts of investor groups you may be involved with such as AIA and ASA which will no doubt be making submissions.

If there is a change of Government, and they enact what they say they're going to, here's what we think will happen.

One last hurrah.

Just this week, Rio Tinto announced a large off-market share buyback. The speculation is that it's at least partly motivated by the wishes of shareholders to see franking credits paid out. If the likelihood of franking refunds being abolished increases, we'll see much more of this type of behaviour. We might see many of our LICs, high dividend payers or companies with large franking balances undertake special dividends, buybacks or other similar transactions

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to get franking credits into the hands of shareholders. So, don't panic and sell them too early. You could find the franking credits you receive over the next 1-2 years are much higher than normal.

Action: Be prepared to take advantage of franking credit payouts - don't sell your dividend payers too early.

The market will restructure.

There will be big changes in financial products, aimed at turning franking credits into cash. For example, one likely change is the conversion of LICs into Listed Investment Trusts (LITs). It doesn't get rid of the problem totally, but it does enable reduced franking credits in return for higher cash distributions. We've already seen a couple of LICs do it and there may well be a flood before any legislation comes into force.

Other examples of potential changes might be restructuring hybrids to remove payment in franking credits and instead pay cash. Or moves by stapled securities (including many REITs and infrastructure funds) to maximise distributions from the trust part of the stapled entity while reducing dividends from the Company. There will be other products that aim to mitigate the impact. We could even see the invention of the anti-franking fund - a strategy that seeks to buy stocks just after they go ex-dividend and sell again before the next dividend to maximise capital gains rather than franked dividends.

Action: Be alert for positive changes to structures and products which might help you to limit the impact of franking credit changes. But see below...

Be wary of some investment alternatives

There's been a lot of discussion around making changes to investment portfolios to replace lost franking credits. Some examples we've seen have included buying growth stocks, infrastructure and property funds and global stocks. The problem right now is that almost all those types of investments are probably more expensive than the high dividend paying "value stocks" you'll be selling. So, tread carefully. The question to ask yourself is "Will I get a better total return by sticking with what I have (without the franking) or moving to something else." The answer in many cases may be to stick with what you have.

One area you might give some thought to though, is to consider buying some LICs or managed funds which can be more resilient in market corrections - such as long/short or market neutral strategies. It's late in the cycle, and if you don't already have some exposure to these types of investments, it may make sense to add some now.

Action: Don't rush into other assets without doing your homework. They may not be better value, even after adjusting for non-refundable franking credits.

You may be able to restructure

If you and your immediate family pay no tax now, you may have limited options to restructure your affairs and escape a hit. It's the reason why the biggest impact of the proposed changes will be on middle-income pensioners, not the wealthy.

However, if you're paying tax, you'll most likely have several options to restructure and reduce the impact. This could include moving dividend-paying assets to tax paying entities, moving super out of an SMSF and into an industry fund, selling direct shares and buying LITs, managed funds or ETFs, reallocating super assets between pension and

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accumulation members or reducing dividends from family businesses. A good financial advisor or accountant can be invaluable in circumstances like these, where changes in the rules require an analysis of your personal situation.

Action: Make sure you have access to a quality advisor and consult them regularly.

In the end, it may not be as bad as you think

While the headlines are ugly and the worst case for many is significant, there are going to be options to mitigate the damage for many investors. If you're affected, the best thing you can do right now is to seek to make your story heard before the election. There's a real chance the changes can be abolished or significantly watered down if the true number of people impacted is understood by our politicians. If not, there will be opportunities for many to reduce the damage. Make sure you stay on top of your options with the help of a good financial advisor or accountant.

Take care and all the best with your investing.

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