EVERGREEN ESSENTIALS

FRANKING

Franking credits offer Australian equity investors significant tax benefits, which results in an enhanced dividend income stream. Put simply, they're a form of tax credit, unique to Australian shares.

A franked dividend occurs when a company pays tax on earnings, and then pays a dividend. The investor receives the tax paid as a 'franking credit' on the dividend.

Many Australian listed companies pay fully franked, unfranked or partially franked dividends.

Why?

The purpose of franking is to prevent taxing a company's earnings twice, as dividends are paid from the company's after-tax profits.

Without franking credits, these profits would be first taxed at the company level and then again at the investor level, where income tax would be paid on the dividend received. Franking credits are a credit for the tax the company has already paid.

As an example, we have three investors:

- Jane invests in an SMSF which pays 15% tax on investment earnings,
- Mike pays 30% income tax and
- Beth pays 45% income tax.

They all hold 300 shares in 123 Corp, which is subject to the standard 30% tax rate on earnings.

In Scenario A, the company pays fully franked dividends. In Scenario B, it pays no franking on its dividends.

DIVIDEND INFORMATION

123 CORP. DIVIDENDS 2021 FINANCIAL YEAR

PAYABLE DATE	DIVIDEND	FRANKING CREDIT	GROSS DIVIDEND
SEP-20	**$3**	$1.29	$4.29
MAR-21	**$2**	$0.86	$2.86
TOTAL ANNUAL DIVIDEND PER SHARE	**$5**	$2.14	$7.14
SHARE PRICE	**$100**		
CORPORATE TAX RATE	**30%**		

SCENARIO A WITH FULLY FRANKED DIVIDENDS

INVESTOR	SHARES HELD	TOTAL HOLDINGS	DIVIDEND INCOME	FRANKING CREDIT	TAX RATE	TAX PAYABLE ON DIVIDEND	TAX PAYABLE AFTER CREDITS
JANE	300	$30,000	$1,500	$643	15%	$321	-$321
MIKE	300	$30,000	$1,500	$643	30%	$643	$0
BETH	300	$30,000	$1,500	$643	45%	$964	$321

In Scenario A above, even though each investor pays a different tax rate on their dividend, they receive the same franking credits. These credits are put towards their tax bill.

Jane's SMSF, which pays a tax rate lower than the company's, receives a net tax refund.

The next example, Scenario B, shows that all three would pay more tax with unfranked dividends.

SCENARIO B WITH FULLY UNFRANKED DIVIDENDS

INVESTOR	SHARES HELD	TOTAL HOLDINGS	DIVIDEND INCOME	FRANKING CREDIT	TAX RATE	TAX PAYABLE ON DIVIDEND	TAX PAYABLE AFTER CREDITS
JANE	300	$30,000	$1,500	$0	15%	$225	$225
MIKE	300	$30,000	$1,500	$0	30%	$450	$450
BETH	300	$30,000	$1,500	$0	45%	$675	$675

Not So Fast

Not all shareholders can claim franking credits.

You must own a company's stock for at least 45 days to be eligible for franking credits. However, those with less than $5000 total franking credits are exempt from this rule.

What You Need to Consider

Super funds and the elderly benefit the most from franking. It benefits super funds as their tax rate on investment earnings is capped at 15%, so they will generally receive tax credits. It also benefits retirees as they often pay a lower tax rate.

Some dividend paying stocks on the ASX are Australian companies with significant international operations, so they pay little tax in Australia. As a result they have little to no franking credits. For example, News Corporation, which pays unfranked dividends, is one of these.

While franking credits can bring tax advantages, you should talk to your financial adviser to ensure this can benefit you and your financial needs.