IMPUTATION CREDITS

HOW IMPUTATION CREDITS WORK

When you invest in shares, (hopefully!) you will receive dividends. Dividends are paid out of company profits. When you receive a dividend, you also receive a credit for any tax that the company has already paid on its profits. This is known as an ‘imputation credit’ (sometimes known as a franking credit).

Imputation credits ensure that the same profit is not taxed twice - once at the company level and again when you receive your dividend.

HOW DO THEY WORK?

When you calculate your personal tax liability, you add the imputation credits to the actual cash you receive. The whole amount is then taxed at your marginal tax rate. This establishes your personal tax liability.

This personal liability is then compared to the imputation credit. If the imputation credit is more than your personal liability, you receive money back from the Australian Tax Office as a tax return. If the imputation credit is less than your own tax liability, you have to pay the extra tax to the tax office.

In this way, the ultimate tax rate that applies to company profits is the marginal tax rate of each individual shareholder.

SUPERANNUATION FUNDS

Superannuation funds pay income tax at a rate of 15%. Companies pay tax at various rates, up to 30%. If a superannuation fund invests in shares, this means that the imputation credit may be greater than the fund’s tax liability. In that case, the superannuation fund gets a tax return.

THINGS TO REMEMBER

Imputation credits are only available on dividends paid by Australian companies. Even then, not all dividends are paid out of after-tax money. So, not all dividends have imputation credits attached. Companies announce whether the dividend is ‘franked’ or ‘unfranked.’

The imputation credit system encourages shareholders – especially ones with low personal tax rates - to invest in Australian companies. It does this because company taxes are only taxed once, at the shareholder’s rate, not the company’s.

If you would like to know more about imputation credits, talk to us today.

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