Forty-Five Days is Too Long

Submission to Re:think – Better tax system, better Australia

By Lorraine May 2015

Executive Summary

The forty-five day rule affects franking credit on share dividends. It was introduced to discourage trading of franking credits between onshore and offshore institutions. Small investors became caught in the cross fire. Anyone with franking credit greater than $5,000 and all SMSF's are affected by the rule.

Forty-five days is too long and the $5,000 limit is too low. The forty-five days could be reduced to fourteen days for small investors or the limit increased to $25,000. This would apply to both individuals and SMSF's.

Forty-five Days is Too Long

The Forty-Five Day Rule

The forty-five day rule affects franking credit on share dividends. It was introduced to discourage the trading of franking credits between onshore and offshore institutions. International share owners receive no benefit from franking credits so were transferring shares for short lengths of time to Australian owners who could benefit from the credit.

Small investors became caught in the cross fire. Any individual with franking credit greater than $5,000 and all SMSF's are affected by the rule.

In practise the shares need to be held for 47 days as the date of buying and selling is not included in the 45 days.

Why it causes problems for small investors

The problem for small investors is that they may not be able to respond to stop losses or sell on share price spikes or dips for over six weeks after buying the shares without losing the benefit of their franking credit on any dividend they are entitled to. This can interfere with investment strategies that have nothing to do with trading of franking credit.

The current level of $5,000 has not been increased since the law was first introduced. This represents the franking credit on dividends of only $11,667. This would be earned on only around $220,000 of bank shares. An investor with this amount is unlikely to be a professional share trader and even less likely to be trading franking credits with offshore investors.

All SMSF's are affected by the rule with no minimum amount of franking credit applying.

Recent Amendments

The rule was recently amended to include investors who sold their shares the day they went ex-dividend then immediately bought them back on the cum-dividend market. This gives an investor the benefit of two dividends and two lots of franking credit in return for a small capital loss. This particularly benefits SMSF's in pension mode as they pay no tax but can claim a refund of the franking credit.

How it Should be Changed

The $5,000 limit is too low and forty-five days is too long. Increasing this to $25,000 for both individuals and SMSF's would be more appropriate.

Alternatively the forty-five days could be reduced to fourteen days for small investors.

If selling on the ex-dividend date and buying back on the cum-dividend market is perceived as a problem (this gives SMSF's the full benefit of two dividends and two lots of franking credit in exchange for a small capital loss) then this could be legislated against as a separate issue to the normal forty-five day rule.