Your Tax Activity 1: Income and income tax

Years 11-12

TASK 3 FRANKED DIVIDENDS: ARE THEY WORTH IT?

Worksheet

Focus: Mathematics

YOU WILL:

- investigate the tax rebate associated with franked share dividends
- analyse the impact of different tax rates on the dividend-price ratio of a share

YOU WILL NEED:

- *Fact sheet: Income and income tax*
- A calculator or spreadsheet

THE POWER OF FRANKING CREDITS: A CASE STUDY

Companies that fully frank their dividends pay the corporate tax rate of 30% on their profit and distribute the remainder to shareholders.

The shareholder receives the credit for the tax already paid by the company and is then only required to pay any 'extra' tax to match his or her individual tax obligations.

In this case study, Bernie holds 500 shares in the company Alpha Holdings for which he paid $24 per share.

Alpha Holdings makes $3 of profit per share and pays 30% tax on that profit.

Alpha Holdings decide to pay shareholders a fully franked dividend. Attached to this dividend is a 30% tax credit, which can be claimed back by the shareholder as a tax rebate.

1. Calculate the fully franked dividend per share.
2. How much did Bernie receive as a fully franked dividend for his 500 shares?
3. Express the dividend as a percentage of the cost of the shares.
4. Complete the following table to determine the impact of the tax credit on investors with different income tax rates.

	Investor 1	Investor 2	Investor 3	Investor 4
Tax rate	0%	19%	30%	37%
Dividend on 500 shares				
Tax credit on 500 shares				
Taxable income (Dividend + tax credit)				
Gross tax due				
Tax payable/refundable (Gross tax – tax credit)				
After tax income (Dividend – Tax payable)				

5. Why was the tax credit added to the dividend before subtracting it again?
6. If Bernie had the same tax rate on income as investor 3, how much was the dividend worth to him for each share after tax?
7. If Bernie had a 19% tax rate on income, the same as investor 2, what was the effective dividend yield after tax as a percentage of the cost of the shares
8. From the 2016–17 income year, the small business company tax rate was reduced to 27.5%. A small business is one with a turnover of less than $10 million.
   a. If Alpha Holdings has a turn over of less than $10 million, a fully franked dividend will then have a tax credit of 27.5%. If Bernie paid 19% tax rate on income, what would the effective dividend yield after tax be as a percentage of the cost of the shares?
   b. Compare the answer to 8a to the answer when the company tax rate was 30% (Question 6). Why does this occur?

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