Franking Credits

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Australian companies paying dividends often pay "franked dividends"

What are franking credits?

The rule.

What are they worth?

Example

Relax…it's fun

What are franking credits?

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Australian companies pay tax on their earnings, they then might pay out those earnings to shareholders as a dividend. So to avoid tax being paid twice on the same earnings the government allows the companies to attach franking credits to the dividends.

Dividends with franking credits attached are a bit like getting a dividend where some of the tax has already been paid for you.

The company earns $100 and pays $30 tax. It the pays shareholders the $70 out in dividends. Those dividends have a $30 tax credit attached called “franking credits”

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What all that means to you is that if you follow the rules a dividend with franking credits is worth a lot more to you than just the value of the dividend.

What are they worth?

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Firstly if you don’t pay tax in Australia franking credits are not worth anything.

But if you do pay tax they are very valuable.

Compare a dividend with no franking to one with 100% franking.

The 100% franked dividend is worth 1.428 x the dividend with no franking.

So a 100% franked dividend of $70 is worth the same as $100 in interest on your bank account or a $100 non franked dividend.

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But you need to follow some rules!

The rule

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There is a rule you need to follow before you are allowed to claim your franking credits.

The 45 Day Rule

You can't just buy a share hold it for one day to get the franking and then sell. You need to hold your share (or ETF) for 45 days at risk before you can claim the credit. That doesn't include buying or selling days so actually its 47 days.

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This rule is in the tax law. Go to the Australian Taxation Office website for more info.

Example

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Here is an ETF’s that pays franked dividends and one that doesn’t.

MVB-Australian Banks ETF

Portfolio of Australian stocks that generate more than 50% of their income from banking. Just holds the banks. Less than 10 shares.

Category: Australian Shares
Estimated Return: 8.57%
How Risky? : Very Risky 5/5

The MVB ETF paid $1.53 in dividends last year 89% Franked so that could be worth $2.11 in which case the yield goes from 5.73% to 7.9%

BILL-Core Cash ETF

Very low risk investment with regular income. Like a savings account.

Category: Cash
Estimated Return: 1.12%
How Risky? : Very Low Risk 1/5

BILL ETF paid $1.45 in dividends last year but with no Franking so the dividend is worth just the $1.45.

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You get to $2.11 by multiplying the franking gross up 0.428 x 89% (the franking rate) = 0.38 then its just $1.53 dividend x 1.38 (1 plus gross up) = $2.11 easy!