



## THE MAIN RESIDENCE EXEMPTION Less Simple Than You Think

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BY WEALTH ADVISER

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Ask most Australians whether they will pay tax when they sell the family home and the answer comes back without hesitation: of course not, the home is tax-free. It is one of the few pieces of tax law that has entered the national folklore, and for good reason. For a great many people it is exactly right. You buy a house, you live in it, you sell it years later, and the capital gain – sometimes a very large one – is entirely exempt from capital gains tax.

The trouble is that the rule most people carry in their heads is the headline, not the fine print. The full exemption applies cleanly only while the home is doing nothing other than being your home. The moment it starts to earn income, sits empty while you treat somewhere else as home, gets subdivided, or passes through a deceased estate, the exemption begins to fray at the edges – and the people most surprised by this are usually the ones who were most confident the home was untouchable. None of these situations is exotic. They are the ordinary stuff of later life: renting out a room, moving in with family, going into care, leaving the house to the children. This article walks through the ones most likely to catch this readership out, and the single idea that ties them all together.

#### BEFORE YOU GET STARTED

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**The first fraying happens when the home starts producing income while you still own it. The two common versions are renting out a room and running a business from home, and although they feel quite different, the law treats them through the same lens.**

### The one rule everything else hangs off

The main residence exemption lives in Subdivision 118-B of the Income Tax Assessment Act 1997. The core provision exempts a capital gain or loss on a dwelling that was your main residence throughout the period you owned it. Two background conditions are worth stating once. The exemption covers the dwelling plus up to two hectares of surrounding land used for private purposes; if your block is larger, you can nominate which two hectares are exempt, but the rest is taxable. And you generally need to be an Australian resident for tax purposes at the time of the sale – a point that has caught out expatriates badly since the rules tightened, which we will come back to.

Everything else in this article flows from a single principle. The home is fully exempt only for the time, and to the extent, that it is genuinely your home and nothing else. Once part of it earns income, or once you are living somewhere else, the law starts apportioning – by floor space, by time, or both – and a slice of the gain becomes taxable. Hold that idea and the complications below stop being a collection of unrelated traps and start looking like variations on one theme.

### When the home earns its keep

The first fraying happens when the home starts producing income while you still own it. The two common versions are renting out a room and running a business from home, and although they feel quite different, the law treats them through the same lens.

If you rent out part of your home – a spare room to a boarder, or the whole place through a short-stay platform while you are away – you lose the full exemption for the portion that is rented, worked out by reference to floor area and the length of time it was let. Rent out a quarter of the floor space for a third of the years you owned the place, and roughly that combined proportion of the gain becomes taxable. The capital gains tax discount of 50 per cent can still apply to that taxable slice if you have held the property for more than twelve months, which softens the result, but it does not make it disappear.

Running a business from home works through a test that surprises people: it turns not on whether you earn income at home, but on whether you could deduct interest on a loan to buy the place. If you set aside part of your home exclusively

as a place of business – a consulting room, a salon, a workshop clearly identifiable as such and not readily adaptable back to private use – you become entitled to deduct a share of occupancy costs, including mortgage interest, and that same share of the eventual capital gain becomes taxable. Crucially, you cannot dodge this by simply choosing not to claim the deduction; the test asks whether you were entitled to it, not whether you took it. The reassuring flip side is that merely working from home for convenience – a laptop at the kitchen table, a study you use because it suits you rather than because your employer has no office for you – does not trigger any of this. The full exemption survives. The line the Australian Taxation Office draws is between a genuine place of business and a place where you happen to do some work.

This is also where a related concession sits that we covered in detail in a separate article in this series: a formal granny flat arrangement can have its own capital gains tax treatment, distinct from the rules described here. If a family is contemplating that path, it is worth reading the two together rather than assuming the home's general exemption simply carries across.

One technical point matters enough to flag. Where a home would have been fully exempt if sold immediately before it was first used to produce income, the law resets its cost base to the market value at that first-income-use date. The effect is that only the gain from the moment it started earning income is in play – but the reset is not optional, it applies only when that “fully exempt immediately before” condition is met, and in a flat or falling market it can work against you. It is the kind of detail that rewards getting a valuation at the right moment rather than reconstructing one years later.

### The home you move out of

The provision that causes the most confusion is the so-called six-year rule, and the confusion usually runs in the taxpayer's favour right up until it doesn't.

When a dwelling stops being your main residence, you can choose to keep treating it as your main residence even though you no longer live there. If the home is earning income during that absence – typically because you have rented it out – that choice is capped at six years. If it is not earning income, you can keep treating it as your main residence indefinitely. The catch is that while you make

this choice for the old home, you generally cannot treat any other dwelling as your main residence for the same period. For someone who has moved into a new home they own, that is a real trade-off, not a free option.

The detail that catches people is what happens past the six-year mark. Imagine you move out and rent the home for eight years before selling. Many people assume that because they were away “under the six-year rule,” the whole thing stays exempt. It does not. The choice protects only six of those eight years; the gain attributable to the remaining period becomes taxable on a proportional basis. The rule rewards selling within the window, or moving back in to reset it – because each time the dwelling genuinely becomes your main residence again and then ceases to be, a fresh six-year period becomes available. A short reoccupation can restart the clock, though the Tax Office looks at whether you actually re-established the home as your residence, not whether you stayed a token week to game the calendar.

### The home and the move into care

Few transitions are as financially tangled as a move into residential aged care, and the main residence exemption is one of several rulebooks that collide at that point. The former home is simultaneously a capital gains tax asset, a Centrelink asset, an aged-care means-tested asset, and an estate asset – and the four do not line up. We have covered the aged-care and Centrelink treatment of the home elsewhere in this series; here the focus is narrowly on the capital gains tax position.

The encouraging news is that the absence rule described above applies just as well to a move into care as to any other reason for leaving. If the home is left vacant, it can be treated as the main residence indefinitely. If it is rented out – often precisely to help fund the cost of care – the six-year cap applies, and the same proportional consequences follow once the absence runs long. For a person who moves into care, rents the home to cover the daily fees, and remains in care for more than six years, a capital gains tax liability can be quietly accruing in the background even though selling the family home is the last thing on anyone’s mind.

This is one of those areas where the tax tail should not wag the dog. The decision about whether to keep, rent or sell the former home turns mostly on cash flow, aged-care means-testing and family circumstances, not on capital gains tax. But it is worth knowing the clock is running, because the difference between selling in year five and selling in year eight can be the difference between a full exemption and a partial one – and that is a knowable, plannable fact rather than a nasty surprise.

### The home you inherit

The last and most intricate scenario is the one almost every family eventually faces: a home passing through a

deceased estate. The governing provision allows the capital gain on an inherited dwelling to be disregarded entirely – but only if the conditions line up, and the most important of them is a deadline.

If the property was the deceased’s main residence just before they died and was not being used to produce income at that point (or was acquired by the deceased before capital gains tax began in September 1985), the beneficiary or the estate can sell it fully exempt provided the sale is settled within two years of the date of death. Miss that window and the automatic full exemption is generally lost – unless the home continues to qualify on a separate footing because it remains the main residence of the deceased’s spouse, of a beneficiary to whom it passed, or of someone granted a right to occupy it under the will. Where none of those applies, what remains is a partial exemption calculated by reference to the days the property was not covered by anyone’s main residence status. The Tax Office does allow some breathing room – a safe-harbour practice gives an automatic extension of up to a further eighteen months where the delay was caused by factors genuinely beyond the estate’s control, such as a contested will or a complex administration, and in harder cases the estate can apply to the Commissioner for a discretion to extend the two years. But none of this is a reason to drift. The two-year clock is the single most consequential date in the whole exercise, and executors who treat it casually can convert a fully exempt sale into a taxable one through nothing more than delay.

A subtlety worth naming for inheriting families: for a post-1985 home, the beneficiary is generally treated as having acquired it at its market value on the date of death, which means only the gain accruing after death is potentially in play. Imagine inheriting a home worth a certain amount at death and selling it three years later, having missed the two-year window. The taxable gain is broadly the increase in value over those three years, apportioned for the period beyond the exemption – not the decades of growth the deceased enjoyed, which fall away. That is a far gentler outcome than many beneficiaries fear, but it still rewards acting promptly. We dealt with the position of a surviving spouse, and the way the home and other assets pass between partners, in a separate article in this series; the rules here apply most sharply where the home passes to children or other beneficiaries rather than to a spouse.

### The traps worth naming, not explaining

Three further situations deserve a flag rather than a full treatment, because each is genuinely complex and each affects a smaller slice of readers. Subdividing the block and selling part of it separately does not enjoy the exemption on the land sold without the dwelling – the exemption attaches to the home, not to bare land carved off it. If you are a foreign resident for tax purposes at the time of the sale, the

**The main residence exemption is generous and, for most people most of the time, it works exactly as the folklore promises. The risk is not the rule itself but the assumption that it is absolute. A few questions are worth raising at your next review. If you have ever rented out part of your home, run a business from it, or moved out and let it, has anyone worked out what that means for the eventual sale – and is there a valuation on file from the right date?**

exemption is generally unavailable altogether for disposals after 30 June 2020 – regardless of how many years you lived in the home as a resident – unless you satisfy a narrow life-events test. It is a harsh rule that has caught Australians who moved overseas assuming their home was safe, and the default is unforgiving. And when you buy a new home before selling the old one, a limited overlap of up to six months lets you treat both as your main residence, recognising that real life rarely allows a same-day swap. Any of these warrants a conversation before acting, not after.

### One asset, four rulebooks

Step back and the pattern is clear. The family home is the most valuable thing most households own, and it is governed not by one set of rules but by four that do not speak to each other. Capital gains tax cares about income use and time away. Centrelink cares about whether you still live there and for how long. Aged-care means-testing applies its own treatment again. And on death the estate rules take over with their own clock. A decision that looks sensible through one lens – renting the home to fund care, say, or holding an inherited property while the market recovers – can quietly trigger a cost under another. The home is not one asset wearing one rule; it is one asset wearing four hats, and the hats are not the same shape.

### Worth thinking about

The main residence exemption is generous and, for most people most of the time, it works exactly as the folklore promises. The risk is not the rule itself but the assumption that it is absolute. A few questions are worth raising at your next review. If you have ever rented out part of your home,

run a business from it, or moved out and let it, has anyone worked out what that means for the eventual sale – and is there a valuation on file from the right date? If a move into care is on the horizon, does the plan for the former home account for the six-year clock, or only for the cash flow? If you are an executor, or expect to be, is the two-year deadline on the calendar with real intent behind it? And if anyone in the family is living or planning to live overseas while still owning an Australian home, has the foreign-resident position been checked? None of these questions has a one-size answer. They are exactly the kind of thing worth putting in front of your adviser before the decision is made, rather than discovering the rule after the sale has settled.

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# Private Health Insurance After 60

## What You're Paying For

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BY WEALTH ADVISER

The annual letter from the health fund has become a small ritual of irritation. The premium has gone up again, by more than wages and more than inflation, and somewhere on the second page there is a line about how proud the fund is of the value it delivers. For many readers in their sixties and seventies, the question has stopped being academic and started being arithmetic. The cover costs thousands of dollars a year. It hasn't been used in any serious way for a decade. The hospital down the road is perfectly competent, and the surgeon the family GP keeps recommending is on the public list anyway. So is this still worth paying for?

The answer is genuinely person-specific and turns on more than the dollar figure on the invoice. But the decision is harder than it needs to be because the system is built from four separate moving parts that most people half-understand and rarely see explained together. The Medicare Levy Surcharge, the Lifetime Health Cover loading, the means-tested rebate, and the underlying choice between the public and private hospital systems each operate on their

own logic. Put them on the table together and the decision stops looking like a leap of faith and starts looking like something you can actually weigh.

### The surcharge: a tax for staying out

The Medicare Levy Surcharge is a tax penalty designed to push higher-income earners into private hospital cover, and it is paid on top of the ordinary 2 per cent Medicare levy. For the 2025-26 income year, it applies to singles with income for surcharge purposes above \$101,000 and to couples and families above \$202,000, with the family threshold lifting by \$1,500 for each dependent child after the first. The rate is tiered: 1 per cent at the lowest band, rising to 1.25 per cent and then 1.5 per cent at the highest incomes.

A few features matter here. The income measured for the surcharge is broader than taxable income – it adds back things such as reportable fringe benefits and reportable employer super contributions, so a household that looks below the threshold on the headline figure can be over it once the surcharge measure is applied. To avoid the surcharge you must hold an appropriate level of hospital cover for the full

## The Lifetime Health Cover loading is the rule that makes people nervous about dropping cover at any age, and the nervousness is sometimes well-founded and sometimes misplaced.

income year; extras-only policies do not count, and gaps of even a few weeks expose those days to the surcharge. The surcharge is what tips the keep-or-drop maths for higher-income households still working – if you would otherwise pay a 1 per cent surcharge on, say, \$130,000 of income, that's \$1,300 a year in tax that holding a basic hospital policy makes disappear.

The relevance of the surcharge generally fades in retirement, when assessable income drops below the threshold. That is one of the reasons the keep-or-drop question becomes live: the most tangible financial reason for holding cover during working life often goes away.

### The loading: a penalty for ever leaving

The Lifetime Health Cover loading is the rule that makes people nervous about dropping cover at any age, and the nervousness is sometimes well-founded and sometimes misplaced.

The loading was introduced in July 2000 to encourage Australians to take out private hospital cover early and keep it. The basic rule is that anyone who first takes out hospital cover after 1 July following their 31st birthday pays a 2 per cent loading on the hospital premium for each year they were aged over 30 without cover, capped at 70 per cent. So a person who first takes out cover at 50 pays a 40 per cent loading; at 65 or older the loading hits its 70 per cent ceiling. Once you have held continuous hospital cover for ten years while paying the loading, the loading drops off and stays at zero so long as you keep your cover.

For most readers of this publication the loading has either long since been worn off or was never incurred in the first place – these are people who have held private hospital cover for decades. That changes the maths of the keep-or-drop decision in an important way. Cancelling cover after the loading has already been served does not by itself reinstate a new loading; what happens if you take out cover again later depends on your prior loading history and the cumulative time you have spent without cover. The system allows a lifetime permitted absence – generally around 1,094 days, or about three years – that can be used in pieces, and the precise effect of any break depends on when and for how long. The point is not that this is simple to navigate, but that the loading is not the trap door many older Australians assume it to be: a considered break to reconsider, or a switch between funds done correctly, does not by itself trigger a 70

per cent loading. The specific consequences for any individual are worth checking before acting, because the rules are nuanced.

### The rebate: the part that gets better with age

The third lever runs in the opposite direction to the first two. The Australian Government Rebate is a means-tested subsidy paid through reduced premiums or as a tax offset, and unlike the surcharge and the loading, it explicitly improves as you get older. The rebate tier turns on income – the same thresholds used for the surcharge, simply applied to the rebate scale – but the rebate percentage at each tier rises in three age brackets: under 65, 65 to 69, and 70 and over.

For the rate period commencing 1 July 2025, a single retiree below the surcharge threshold (the base tier) receives a rebate of 24.288 per cent of premiums if under 65, 28.337 per cent at 65 to 69, and 32.385 per cent at 70 and over. These rates apply for the current rebate adjustment period and are reset each 1 April under a formula that has tended to nudge them gently downward over time. The age-band step-ups, though, remain a structural feature of the system. For a couple or family policy, the rebate is calculated on the age of the oldest person covered – so when the older partner crosses 65 or 70, the rebate increases for the whole policy. It is a small piece of the system that genuinely rewards staying in. The rebate at base-tier income can meaningfully reduce the headline premium: a \$4,000 nominal premium might net out closer to \$2,700 or \$2,800 for a couple in their seventies, though actual outcomes vary by fund, state and policy tier.

One change worth flagging directly, because it materially alters the maths for a large cohort of this readership if it proceeds. As part of the 2026-27 Federal Budget delivered in May 2026, the government announced that from 1 April 2027 the higher age-based rebate percentages for those aged 65 and over would be reduced to align with the under-65 rate at each income tier. In practical terms, the 28.337 per cent rebate for 65 to 69 year-olds and the 32.385 per cent rebate for those 70 and over would both step down to 24.288 per cent at the base tier, with corresponding reductions in the other tiers. Industry analysis suggests this would translate to around \$226 to \$255 a year in additional premiums on average for affected policyholders. At the time of writing, the change is a Budget announcement: legislation

is intended to be introduced ahead of the April 2027 commencement, but parliamentary passage is not assured, and the measure has attracted active opposition from industry, retiree advocacy groups and some parliamentarians. Readers should treat the change as planned rather than legislated, and confirm the position before making decisions that turn on it.

### What the cover actually buys in later life

The financial machinery is the easier half of the decision. The harder half is what the cover delivers in your sixties, seventies and eighties that Medicare and the public system do not. This is the part of the conversation where the article either earns its keep or feels evasive, so it is worth being direct.

The most useful frame is to separate health care into two broad categories. Emergency and acute care – heart attacks, strokes, serious accidents, sudden severe illness – is generally where the Australian public system performs strongly. Public hospitals handle these cases regardless of whether you hold private cover; you are not waitlisted into a stroke. For this kind of care, private hospital cover delivers a different experience (potentially a private room, your treating doctor of choice, no shared bays) rather than a different outcome. For some people that experience matters a great deal; for others it does not justify the annual cost.

The category where private cover most clearly changes access and timing is elective and timed surgery – the procedures that become more common with age. Joint replacements, cataract surgery, hernia repairs, certain cardiac procedures, prostate and gynaecological surgery, varicose vein and skin work. Public waiting lists for these procedures can run from months to several years depending on the state, the hospital and the urgency category assigned. Private cover does not eliminate waiting altogether, but it generally compresses it materially, and it lets you choose the surgeon, the hospital and, within limits, the timing. For a person who develops a hip that needs replacing at 70, the difference between waiting many months in the public system and a much shorter period privately can be the difference between a year of pain and a year on the golf course. Whether that is worth several thousand dollars a year depends on individual circumstances, but the comparison is at least concrete. The clinical outcome – how good the new hip ends up being – is typically similar in either system when the procedure is finally done; what differs is when it gets done, who does it, and the experience of getting there.

Three further realities are worth knowing. First, private hospital cover does not eliminate out-of-pocket costs. The gap between what the fund and Medicare pay together and what specialists charge can be substantial, particularly for procedures where the surgeon's fee, the anaesthetist's fee

and the assistant's fee are each subject to their own gap. Some funds offer gap cover arrangements with participating doctors that reduce the gap to a small known amount; others leave more variable exposure. The headline premium is the start of the cost, not the end of it.

Second, the cover comes in tiers – Basic, Bronze, Silver and Gold – and what each one includes is now standardised across funds. Lower tiers exclude many of the procedures most relevant in later life: hip and knee replacements are typically Silver or Gold inclusions, cataracts are usually covered from Silver upwards, cardiac surgery often requires Gold. The retiree who has downgraded to Bronze to save on premiums may have inadvertently dropped the cover for the procedures most likely to actually come up. Reading what your policy includes – not what it costs – is the half of the decision most people skip.

Third, extras cover (dental, optical, physiotherapy, and the rest) is a separate product to hospital cover and operates on quite different logic. Extras tend to be value-for-money for households that consistently use them and questionable for those that do not – the rebate, claim limits and the relationship between premium and benefit reward measurable usage rather than insurance against catastrophe. The keep-or-drop question for extras is best treated on its own terms; it is not part of the hospital cover surcharge-loading-rebate framework at all.

There is a fourth point that completes the picture without dwelling on it. Dropping private hospital cover does not mean going without health care. Medicare remains the universal backstop, and for many people it delivers what they actually need. The keep-or-drop decision is not between cover and no care; it is between cover and the public system. Naming that helps clear away the unspoken assumption that often sits in the background of the conversation.

### Putting it together

Pull the four levers into one view and the keep-or-drop question stops being a single decision and becomes a series of judgements at different income levels and life stages. For someone still working with income comfortably above the surcharge threshold, the surcharge is doing real work and basic hospital cover is usually cheaper than the tax it avoids. For a retiree with income below the surcharge threshold, the surcharge falls out of the calculation entirely and the decision rests on the rebate-adjusted premium against the value of the cover in elective procedures. For someone in their seventies who has held continuous cover for decades, the rebate is at its most generous, the loading has been wiped clean, and the question is largely about whether the policy tier still covers the surgeries that age is making more likely.

What these scenarios share is that the decision is rarely about whether private cover is “worth it” in the abstract. It

is about whether this policy at this premium with this rebate covers what is actually likely to be needed in this household over the next decade. That is a question worth bringing to a review rather than one to settle alone on the kitchen table with a frustrated sigh and a fund letter.

### A boundary worth naming: aged care is a different system

One persistent misconception is worth clearing up before the close, because it sits silently behind a lot of keep-or-drop reasoning. Private health insurance does not fund residential aged care or home care. The aged care system has its own funding architecture – government subsidies, means-tested daily fees, accommodation payments and the like – and we have covered that ground in detail in separate articles in this series. Hospital cover funds hospital and medical treatment, including the surgeries and admissions that age makes more likely, but it does not extend across the line into the aged care system. Readers who have been keeping private cover partly in the back-of-mind belief that it will help with care later should know that it will not, and should weigh the decision on the basis of what it actually does.

### Worth thinking about

The keep-or-drop conversation is one of the most personal financial decisions older Australians make, and it is rarely served well by either a defensive “keep paying” reflex or a frustrated “just drop it” reaction. A few questions are worth raising at your next review.

Does your current policy tier still cover the procedures most likely to matter in the next ten years – joint replacements, cataracts, cardiac, prostate or gynaecological work – or has a previous downgrade quietly stripped them out? At your current income, is the surcharge still doing real work, or has it ceased to apply? What is your loading status,

and what does the cumulative absence rule allow you in practical terms? For couples, does the age-band rebate step-up at 65 or 70 change the maths, and is the rebate being claimed at the right tier? If you dropped cover today and the household’s circumstances changed in three years, what would re-entry actually cost? And, separately, is the extras cover earning its keep, or is it being kept paid up out of habit rather than usage?

None of these has a universal answer. They are precisely the kind of thing worth working through with your adviser, with the actual premium, rebate, income and policy schedule on the table – because the decision is genuinely worth getting right, in either direction.

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# Franking Credits

## The Most Australian Thing About Your Portfolio

BY WEALTH ADVISER

**T**he cheque – or these days the bank deposit – arrives sometime after the tax return is lodged. For a self-funded retiree with a portfolio of Australian shares, it can be a substantial sum: several thousand dollars in some years, a few hundred in others. There is no obvious source. No employer has paid it; no investment has been sold; no dividend hits the account that month. It is simply money from the tax office, refunding tax that someone else has already paid on the retiree’s behalf.

This is franking credits doing what franking credits do, and the experience of receiving that refund is so common in Australia that we tend to forget how strange the underlying system is. Hardly any other country has refundable dividend imputation. Plenty of countries have grappled with the problem franking solves – the double taxation of company profits, once when the company earns them and again when shareholders receive them as dividends – but Australia’s solution, of attaching tax credits to dividends and refunding any excess in cash to shareholders who haven’t used them up, is genuinely unusual. It shapes how Australian investors build portfolios, why they hold so many bank and mining shares, why retirees in particular love high-yield Australian

equities, and why the system periodically becomes the centre of an election fight.

For most readers of this publication, franking is something experienced more than understood – the dividend statement arrives with a “franking credit” column, the tax return absorbs it, the refund eventually appears, and it works. This article walks through what is actually happening behind that experience, what it means at different life stages, and the genuine planning tensions it creates.

### What is actually going on

The starting problem is straightforward. When a company earns a profit, the company pays tax on it – currently 30 per cent for larger Australian companies, or 25 per cent for smaller “base rate entity” companies. When that after-tax profit is paid out as a dividend, the shareholder receives it as income and, without some adjustment, would pay tax on it again at their personal rate. The same dollar of profit would be taxed twice.

Dividend imputation was introduced by the Hawke and Keating government in 1987 to fix this. The idea is that when a company pays tax, it earns a credit – a “franking credit” or “imputation credit” – that it can attach to dividends when it distributes them. The shareholder receives

**The same franked dividend produces materially different outcomes depending on whose hands it lands in, and the two cases that capture the picture for this readership best are the working professional in their fifties and the retiree drawing a pension from super.**

the cash dividend, plus a franking credit representing the tax the company has already paid on their share of the profit, and the two together are what the shareholder declares as income on their tax return. The franking credit then acts as a tax offset, reducing the shareholder's tax bill by the amount of tax the company already paid.

For a fully franked dividend, the arithmetic works cleanly. Suppose a company pays you \$70 as a fully franked dividend. Attached to that dividend is a franking credit of \$30 – the 30 per cent company tax already paid on the \$100 of profit that produced the dividend. On your tax return, you declare \$100 of income (the cash plus the credit, what's called the "grossed-up" dividend) and claim a \$30 tax offset. If your marginal tax rate happens to be 30 per cent, the result is exactly neutral: you owe \$30 of tax on the \$100 grossed-up income, the franking credit covers it, and the \$70 in your pocket is yours. If your marginal rate is higher, you owe a top-up; if it's lower, the credit exceeds the tax owed.

The distinctively Australian piece is what happens with that excess. From the year 2000, when the Howard and Costello government extended the system, excess franking credits became refundable: if your franking credits exceed your total tax liability for the year, the difference is paid to you as cash. Before 2000, excess credits were simply lost. The 2000 change is what turned franking from a tax-fairness mechanism into a meaningful source of income for retirees with no other tax to pay, and it is what makes the system politically distinctive.

Two technical points sit alongside the core mechanics. Not every dividend is fully franked – companies can choose to pay dividends as fully franked, partly franked, or unfranked, depending on whether they have franking credits available to attach. And to claim the franking credit, shareholders must generally have held the shares "at risk" for at least 45 days around the dividend date (90 days for certain preference shares), with a small-shareholder exemption that disapplies the rule for individuals whose total franking credits for the year are below \$5,000. The 45-day rule was introduced to discourage short-term trading purely to capture franking credits, and the small-shareholder exemption is what stops it tripping up ordinary retail investors.

### The two life stages where franking really matters

The same franked dividend produces materially different outcomes depending on whose hands it lands in, and the two cases that capture the picture for this readership best are the working professional in their fifties and the retiree drawing a pension from super. Holding the same shares, paying the same dividends, attracting the same franking credits, they end up in genuinely different places – and the contrast is the easiest way to see what the system does.

Consider a couple in their fifties, both working, with a portfolio of Australian shares held in personal names alongside their super. A \$700 fully franked dividend arrives with \$300 of franking credits attached. They declare \$1,000 of grossed-up income and claim a \$300 franking offset. If their marginal rate is 32 per cent on that income (the rate after Medicare levy for taxable incomes in the second-top band), they owe \$320 of tax on the grossed-up dividend; the \$300 franking credit covers most of it, leaving \$20 of tax to pay. Their effective tax on the dividend is mild: the franking credit has done most of the work, but it has not produced cash back. At a higher marginal rate they would owe more on top; at 47 per cent (the top marginal rate plus Medicare levy), they would owe \$470 of tax on \$1,000 of grossed-up income, with the \$300 credit reducing that to \$170. Franking softens the tax bill at every marginal rate; it eliminates it cleanly only at 30 per cent.

Now consider their retired neighbours, drawing an income stream from super in pension phase. Earnings on assets supporting a pension are tax-free in the super fund up to the transfer balance cap – a topic we have covered separately in this series – and any tax-free pension paid to a member over 60 from a taxed source is also tax-free in the member's hands. When the same \$700 dividend lands in a fully pension-phase fund, the fund's tax rate on the pension assets is zero. The \$300 franking credit attached to the dividend has nothing to offset, because there is no tax to pay. So under the refundability rule, the credit is paid to the fund as cash. The fund receives the \$700 dividend plus a \$300 refund from the Tax Office. The retired couple, who paid no tax to earn this, are nonetheless better off by the full \$1,000. In a fund with both accumulation and pension members, or with a mix of segregated and unsegregated

assets, the calculation is more involved – the proportion of the fund supporting pension liabilities is worked out under the exempt current pension income rules and the refund applies to that proportion – but the underlying principle is the same.

This is the engine that powers a great deal of self-funded retirement strategy in Australia. For a portfolio of fully franked Australian shares yielding 4 per cent before franking, the grossed-up yield works out to around 5.7 per cent after the franking credit is added – that is, assuming the dividends are fully franked at the 30 per cent company tax rate; partial franking produces a smaller uplift. The franking refund is not a small benefit; it is a meaningful chunk of total return. For super in accumulation phase the picture sits between the two cases – the fund pays 15 per cent tax on its income, so a 30 per cent franking credit produces a partial refund that the fund can use against tax on contributions or other earnings. The same franked dividend therefore behaves like a moderate tax saver in accumulation and a cash-generating asset in pension.

The principle generalises to other ownership structures. Family trusts and discretionary trusts can pass franking credits through to beneficiaries, where they are then used by the individual according to that person's tax position. The same \$300 credit can be valuable to one beneficiary and indifferent to another, depending on their marginal rates. Companies receiving franked dividends use the credits against their own tax liability and cannot get a cash refund of excess credits, although unused franking offsets can generally be converted into a tax loss and carried forward to future income years – so the credit is preserved rather than refunded. The structural lesson is consistent: franking credits are most valuable in the hands of zero-tax or low-tax recipients, and the Australian system is one of the few that turns that value into cash rather than letting it expire.

### The political history, briefly

Refundability has been politically contested in a way that the broader imputation system has not, and any honest article on franking has to acknowledge the recent history. In the 2019 federal election campaign, Labor proposed to remove the cash refundability of excess franking credits for most recipients, while leaving the underlying imputation system in place. The argument was that refundability was a relatively recent extension (the 2000 Howard and Costello change), that it had grown to cost the budget several billion dollars a year, and that most of the benefit accrued to higher-wealth retirees with self-managed super funds in pension phase. The counter-argument, made loudly by retiree advocates, was that the policy would impose a sudden income cut on people who had structured their retirements around the existing rules in good faith, and that “refund”

was a misleading word for what was in substance a credit for tax already paid.

Labor lost the 2019 election, the policy did not proceed, and refundability remains the law. But the episode is worth bearing in mind for planning purposes – not because anyone is predicting another attempt, but because it illustrates a broader principle that applies to any retirement income strategy heavily reliant on a single tax concession. Concentration risk is concentration risk whether it sits in a single stock, a single sector or a single piece of tax law, and a portfolio whose income depends materially on franking refunds is one whose underlying assumption is that the rule will not change. That assumption has held since 2000 and may well hold indefinitely. But a robust plan does not depend on it doing so. This is the kind of judgement worth raising in a planning conversation rather than assuming away.

### What franking means for how Australians invest

Step back from the mechanics and the planning implications come into focus. Franking creates a real, measurable benefit for Australian investors holding Australian shares – and it does so in a way that is materially more valuable to retirees on low or zero marginal rates than to higher earners. That benefit is genuine and worth capturing. But it also creates a structural pull toward Australian shares that has consequences worth thinking about.

The first consequence is home-country concentration. The Australian share market is around 2 per cent of global market capitalisation. An Australian investor with, say, 70 per cent of their equity exposure in domestic shares is therefore holding a portfolio that bears little resemblance to a globally diversified one. Some of that home-bias is rational – currency considerations, knowledge of local companies, and the franking benefit itself all argue for some domestic tilt – but franking can easily push the tilt further than diversification would otherwise justify. We have covered the currency and hedging dimensions of this question in detail in a separate article in this series.

The second is sector concentration within the Australian market. The high-franking, high-dividend Australian shares are clustered in a relatively small number of sectors: the big banks, the major miners, the supermarkets, the telcos. An investor optimising for franking yield ends up with a portfolio dominated by these names, with consequences for the diversification of underlying business risks. Issue 127 covered the equal-weight and factor-investing approaches that try to address this concentration directly, and Issue 120 discussed the broader Australian equities reporting-season picture.

The third is the income-versus-total-return question. Franking encourages investors to think about portfolios

in terms of income – what the dividend yields, what the grossed-up yield is, what the cash refund will be – rather than total return, which combines income and capital growth. For a retiree drawing income to live on, that framing has obvious appeal. But it can also bias allocations toward mature, high-payout companies and away from growth-oriented ones, with effects on long-term portfolio outcomes that may not always be intended. Issue 118 and Issue 123 covered the broader income-strategy question and the place franking-rich Australian equities occupy within it.

None of this is an argument against franking, which delivers real value to Australian investors when used sensibly. It is an argument for not letting the tax benefit run the portfolio. A franking credit is a useful piece of after-tax return; it is not, by itself, an investment strategy.

### Worth thinking about

For most readers, franking is doing its work quietly in the background – the dividend statements arrive, the tax return absorbs the credits, the refund appears, and the system delivers what the system delivers. A few questions are worth raising at your next review to make sure the quiet operation is the right operation for your situation.

What proportion of your portfolio's return is currently coming from franking refunds, and how robust is your plan if that source were reduced – by a policy change, by your circumstances shifting, or simply by the companies you hold paying less franked dividends? Does the share of your portfolio in Australian equities reflect a considered decision about diversification, or has it crept up because franking-rich shares were appealing in isolation? For couples, are the shares held in the right name – is one of you sitting on franking credits in a high-bracket personal name when the same shares in pension-phase super would be producing refundable cash? If you hold shares in a family trust, has

the franking flow-through to beneficiaries been considered alongside the trust's other distribution decisions? And if you are in or near pension phase, has the value of franking refunds been weighed against the cost of the home-market concentration that may have built up to capture them?

None of these has a one-size answer. They are the kind of question worth bringing to a review with the actual dividend statements, fund tax returns and portfolio composition in front of you – because franking is a genuinely good piece of tax design, and the readers who get the most out of it are the ones who understand what it is doing rather than just enjoying the refund when it arrives.

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# Q&A: Ask a Question

## Question 1

### **I'm retired and my health insurance premiums keep climbing. Is private cover still worth keeping at my age?**

It's a fair question, worth working through rather than answering by reflex. In retirement, the Medicare Levy Surcharge – which often justifies cover during higher-earning years – usually no longer applies, since income generally drops below the relevant thresholds. One of the main financial reasons for holding cover during working life falls away.

The Australian Government Rebate, on the other hand, becomes more generous with age. It steps up at 65 and again at 70, which partially offsets rising headline premiums.

The real question is what the cover delivers that the public system does not. For emergency and acute care, public hospitals perform strongly. Private cover most clearly changes things for elective surgery – joint replacements, cataracts, cardiac procedures and similar work that becomes more common with age. It doesn't eliminate waiting but generally compresses it and lets you choose your surgeon and hospital.

Worth checking too whether your current policy tier still includes those surgeries – a previous downgrade may have quietly stripped them out. And note that private cover does not fund residential aged care, despite a common assumption to the contrary. A conversation with your adviser, with the actual premium and policy schedule on the table, is usually time well spent.

## Question 2

### **I'm moving out of my home and planning to rent it out for a few years. I've heard about a "six-year rule" – does that mean I can sell it later without paying capital gains tax?**

Sometimes, but the detail matters. When a dwelling stops being your main residence, you can choose to keep treating it as your main residence even though you've moved on. If the property is rented during that absence, the choice is capped at six years. If it sits vacant, you can keep treating it as your main residence indefinitely.

There's a trade-off worth noting: while you apply this choice to the old home, you generally can't treat any other dwelling

– including a new home you've bought – as your main residence for the same period. If you own and live elsewhere in the meantime, you may be deferring rather than avoiding tax on one of them.

What catches people is what happens past six years. Rent the home for eight years before selling, and the choice protects six of those years, not all eight; the gain attributable to the remainder becomes taxable on a proportional basis. Moving back in and genuinely re-establishing the property as your main residence – not just staying a token week – can reset the clock for a fresh six-year window.

Because this interacts with both your current and future home decisions, it's worth mapping out with your adviser before committing.

## Question 3

### **My father recently passed away and left me the family home. Someone mentioned there's a two-year window I need to be aware of for tax purposes. What does that mean?**

It's one of the more consequential deadlines in estate administration, and missing it can turn a fully tax-free sale into a partially taxable one.

If the property was your father's main residence just before he died and was not being used to produce income, it can generally be sold free of capital gains tax – provided settlement occurs within two years of the date of death. The exemption can also continue if the home remains the main residence of a surviving spouse, of a beneficiary, or of someone granted a right to occupy under the will.

If none of those applies and the sale falls outside the two years, only a partial exemption is available, calculated by reference to the days the property was not covered by anyone's main residence status. The Tax Office does allow an automatic safe-harbour extension of up to 18 months where genuine delays – such as a contested will or complex administration – were beyond the estate's control.

One softening detail: for a post-1985 home, you're generally treated as having acquired it at market value on the date of death, so only growth from that point is potentially taxable, not the decades your father enjoyed.

Because the clock is the consequential piece, flagging it early with your adviser and the estate's solicitor helps keep options open.

With all these topics, there is no single "right" choice. Your personal situation matters, and you should seek advice from a licensed financial adviser to understand what is most appropriate for you.