Submission to the Senate Inquiry into Treasury Laws Amendment (2023 Measures No. 1) Bill 2023

I believe the abolition of double taxation of corporate profits with the introduction of dividend imputation in 1987 has served the Australian economy and its citizens well. Consequently, I regard any move to modify the system deserving of scrutiny.

In this instance, I am concerned that some of the changes proposed in this Bill are unfair to certain interests and will impose a degree of uncertainty on shareholders and corporate managements that is damaging and unacceptable. If one considers the possible unintended consequences, it seems likely the claimed budgetary gains will not be realised. Indeed, the gains claimed under the Schedule 5 arrangements may even be negative, as corporations--especially large companies--adapt in ways apparently not anticipated. The effects on companies, shareholders (direct and indirect) and especially charities may also be adverse and regrettable.

For the record, I have invested directly in shares for 65 years and established a continuing self-managed family superannuation fund in 1998. I have participated in several off-market buy-backs and continue to benefit from franking credits attached to dividends paid to me directly or through dividends paid to my super fund. I rely on these benefits to support me and my family. I am a self-funded retiree and believe dividend imputation has, in no small measure, enabled me to be financially independent. Interestingly, through compulsory superannuation, this would also be the case for hundreds of thousands of Australians who have no knowledge of how to invest directly in shares and of dividend imputation. The number of individuals similarly benefiting and drawing less than a full Commonwealth pension is possibly greater.

My concerns centre on the changes proposed in Schedules 4 and 5.

Schedule 4 – Off-market share buy-backs

159GZZZPA No part of off-market purchase price is a dividend if the company is a listed public company

Compared to existing arrangements, this would prevent the payment of any franking credits as part of the transaction and align the treatment with on-market buy-backs. While the symmetry may be appealing to Treasury, such an attitude is both facile and superficial: there are a number of effects I would like to be assured Treasury has identified and modelled. The principal beneficiaries of these buy-backs where the capital value is set below the clearing price are non- or low-tax paying entities—individuals, super funds and *charities.* (As a former director of a non-taxed entity—a university residential college—I have experienced the value of these credits first-hand.) The denial of franking credits will hit some of these entities particularly hard with possible implications for welfare support. A further implication that seems not to have been touched upon by commentators is the distinction often made in bequests between capital and income. By preventing a buy-back payment being treated as a dividend--whether franked or not--a beneficiary entitled only to participate as to income will be affected. This will seriously affect charities and entitled minors.

If implemented, I expect off-market buy-backs will be discontinued and some companies will choose not to take the on-market option, resulting in some instances of less than optimal capital management, reduced profitability, less tax paid and reduced shareholder returns.

Schedule 5 – Franked distributions funded by capital raisings

207159 Distributions funded by capital raisings

My concern for the implications of this section of the Bill is significantly heightened. The proposed changes show little understanding of the demands of financial management in modern companies and the wide and unfettered discretion it will bestow on the Australian Taxation Office to deny franking is breathtaking. Uncertainty is anathema to companies and investors. The lack of specification surrounding equity raisings—before and after—deemed to be linked to the payment of a franked dividend is profound and will certainly induce behavioural changes—mostly deleterious to corporate Australia and Treasury's revenue-raising objectives. The resultant effects on the health and competitiveness of Australian business should be considered more fully before these changes are enacted.

Since there is nothing to prevent companies obtaining the desired liquidity through issuing debt—and interest is tax deductible—the likely result is, *ceteris paribus*, less company tax paid and higher corporate leverage, with the attendant risks. This option will be more available to large companies and, given the lack of depth in the domestic corporate bond market, these monies will be sourced in large measure, and interest paid and taxed, offshore.

The case of small successful companies transitioning from establishment losses and still needing capital to grow, seems to have been overlooked. Such companies will want—even need-- to reward shareholders with a dividend—which new-found profits will allow to be franked—and, at the same time, want to raise fresh equity to pursue growth options. Such companies will be *very* limited in their access to debt. I am surprised that no consideration seems to have been given to delivering such a blow—even if only due to uncertainty—to entrepreneurship.

I am concerned that the incentive for Australian equity investors to invest in Australian companies will be reduced. One of the key factors in where to invest will change, quite likely to the detriment of Australian companies seeking funds.

Equally important would be the effect on investment decisions by Australian companies. If their ability to frank dividends is curtailed they may no longer continue to favour Australian-based investments. Companies with large international footprints and large franking balances –think BHP and RIO, for example--will be forced to factor in the loss of an important benefit when making investment decisions. The relative attractiveness of offshore investments will increase and companies will be inclined to reduce their Australian tax obligations.

The implications for the level of employed Australians, tax collections and increased reliance on welfare should be obvious and worrying.

With the imputation system so embedded in the workings of the Australian economy, even changes which have been described as “minor”--presumably to fly under the radar--can have significant and far-reaching effects—many of them possibly unseen and unintended. Locking up franking credits within companies is a corruption of dividend imputation for doubtful benefit.

Notwithstanding the pre-election assurances of the government that they will not re-visit franking, it seems that having failed in the Shorten era to deny the benefits of franking to certain shareholders, the objective now is to prevent Australian companies from paying them to an even larger group of resident shareholders.

I wish the Senate Committee members well in their deliberations and trust they will consider these matters with the knowledge and care they demand.

Robert E G Nicol
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