Wilson Asset Management
Making a difference

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Opening Statement - Jesse Hamilton, Chief Financial Officer, Wilson Asset Management

Thank you, Committee Members, for allowing me to the opportunity to speak today on behalf of Wilson Asset Management and our shareholders. I am a qualified Chartered Accountant with over 15 years of industry experience. I wanted to start with saying I echo Geoff Wilsons comments made today on the draft legislation we are here to discuss.

Schedule 4: Off-markets share buy-backs.

In relation to Schedule 4 regarding off-market share buy-backs and franked dividend payments, while we believe companies should have the freedom to manage their capital in a way that they choose, in the best interests of their shareholders, we recognize the budget needs repair, and we are not arguing with that fact. There has been a lot of misrepresentation in terms of information discussed about this proposed legislation and who it impacts but putting that to one side, we see few issues with the proposal itself.

Unfortunately, the draft legislation goes too far on one point - in particular it unfairly punishes companies who legitimately use an off-market share buy-back as part of a restructure/re-capitalisation by taking away part of their franking account balance or forcing them to pay a franking deficit tax. We have proposed to remove this section of the draft legislation in our submission made to the Committee.

Schedule 5 - Capital Raising and Franked Distribution.

With respect to Schedule 5 and Franked Distributions and Capital Raisings, the draft legislation is currently too broad in its nature and rather than specifically targeting the circumstances of mischief the government is concerned about, it will capture thousands of legitimate company operations and have broad sweeping unintended consequences for Australia and our economy.

In 2015 there was an ATO taxpayer alert as outlined in our proposal using Harvey Norman, Vita Group and Tabcorp as specific examples of corporate behaviour the tax office and the government was looking to limit. The proposed legislation in Schedule 5 from the government however is not limited to these specific examples and behaviours that were identified at the time and it goes beyond a simple tax integrity measure as it has been communicated. The legislation needs to be re-drafted and limited to these circumstances if it is to be continued at all. In 2021, the ATO interestingly found that the instances it highlighted in its 2015 tax-payer alert are, and I quote, “no longer prevalent in the large public and multinational business population”. So, the question needs to be asked, if these instances no longer exist, what is the real intention behind the proposal? And how broadly will it be applied? And why has it been drafted more broadly than the taxpayer alert? This is in addition to the clear risk it presents to small and medium sized companies that it will impact.

The current franking system works in harmony between corporate Australia, Australian investors and the government. It incentivises companies to invest in Australia, employ Australians, pay tax in Australia and in turn it encourages Australian investors to own Australian businesses. Company

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and investor behaviour will always be motivated by the incentives and disincentives presented to them at any particular time.

By altering the franking system under Schedule 5, large Australian companies with mature franking account balances are put at an advantage over small to medium sized entities. The incentive for them to continue investing in and paying tax in Australia will diminish under this proposal and lead to a significant reduction in corporate tax paid, worsening the federal budget. The draft legislation reduces the value of franking credits for Australian companies and will lead corporate Australia on a path of tax minimisation and deferral. It will incentivise possibly the most motivated and smartest group in Australia to minimise or defer their tax payments, something none of us here today want.

There is approximately $36 billion in tax paid each year by corporate Australia that does not get paid out in fully franked dividends to shareholders in the year it is paid, with the vast majority accruing to large entities. Excess franking credits reduce the company's incentive to pay tax in Australia should these changes go ahead. Collectively, corporate Australia as a whole, would only have to look to minimize or defer their tax paid by 0.14% in year one in order to make the Schedule 5 $10 million per year forward savings estimates uneconomical. A simple 2.5% to 5% reduction or deferral in corporate tax payments not paid out in franked dividends to shareholders each year would lead to a $900 million to $2 billion cash flow problem for the federal budget.

Large companies are also put at a significant advantage under the draft legislation whereby they have the ability to take on external debt to pay out fully franked dividends versus raising capital from their shareholders, something small to medium size entities do not have the luxury of regardless of what industry they operate in.

Established Practice Test

The proposed changes will disadvantage companies that do not make regular distributions to its shareholders, such as privately held, or newly established small-to-medium sized companies. It will also catch companies that pay regular fully franked distributions who are looking to reward shareholders with a special dividend, unrelated to the circumstances of mischief that Treasury is looking to target.

The list of legitimate solutions that would not constate "established practice" is large and an "established practice" test does not act as a sufficient filter to distinguish between tax avoidance and the legitimate and normal operations of many businesses.

Furthermore, it provides a competitive advantage again to large, mature Australian companies that have a long history of paying fully franked dividends over small-to-medium size companies who have not yet paid or have infrequent payments due to their shorter history. This test should be materially re-designed or abolished.

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Risks to renewable energy sector.

An issue also arises with renewable energy in Australian with the proposed legislation. Small to medium sized businesses rely heavily on access to capital to generate scale to compete against foreign and large Australian energy companies. Currently the path to net zero in Australia beyond 2030 relies heavily on investment in technology that currently does not exist or requires significant development over the next two decades. These changes will have a significant impact for renewable energy companies relying on Australian capital to grow and compete as part of this transition. By altering the franking system and introducing this legislation, the cost of capital will rise for all Australian businesses, especially those in a growth phase and those capital-intensive businesses. The legislation will limit companies' ability to raise capital from their shareholders and pay fully franked dividends, instead forcing them into external debt funding. In turn, without access to a low-cost capital through fully franked dividend payments, renewable energy companies will face a significant hurdle in raising new capital to invest in and develop new technology. It undermines and risks Australia's ability to generate the renewable capabilities it needs in the coming decades. Furthermore, it places more power behind companies like Rio and BHP who have the ability to take on debt to pay franked dividends and invest in these projects.

As Geoff outlined, if the legislation is passed, it will discourage companies and shareholders from investing in Australia, significantly increasing the cost of capital for Australian companies (both big and small), leading to a reduction in local manufacturing, less local jobs and the long-term ownership of Australian growth companies in this sector.

Conclusion

In summary, we respectfully request the government makes a simple amendment to Schedule 4 and considers re-writing Schedule 5 to remove the unintended consequences and narrow the scope of the legislation to the examples of mischief the government are trying to eliminate.

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Response to Senator Bragg

Senator Bragg – please provide numbers to demonstrate the $10 million per year forecast under Schedule 5 isn't accurate.

The question was raised with respect to the $10 million per year in the forward estimates to be raised under Schedule 5, according to Treasury. As set out in Wilson Asset Management's submission to the Senate Committee, there was approximately $36.6 billion[1] in tax paid in 2019/20 by corporate Australia that did not get paid out as fully franked dividends to shareholders in that year, with the vast majority accruing to large entities. We estimate the figure would now be about $40 billion that wasn't paid out as fully franked dividends in the year paid.

Excess franking credits will reduce the company's incentive to pay tax in Australia should these changes go ahead. Collectively, corporate Australia as a whole, would only have to look to minimize or defer their tax paid by 0.14% in year one in order to make forward estimates of $10 million per year from Schedule 5, uneconomical.

A simple 2.5% to 5% reduction or deferral in corporate tax payments not paid out in franked dividends to shareholders each year would lead to a $1 billion to $2 billion reduction in revenue to the Federal Budget.

Listening to the statements from the ATO and Treasury demonstrates that there does not appear to be a logical or even reasonable basis for the $10 million per year amount, especially given these supposed costings have not changed since 2016. We believe this is also supported by Treasury's unwillingness to release the modelling itself. The modelling does not appear to look at second and third order effects, and clearly does not capture the behavioral changes that would take place with large, mature Australian companies minimizing or deferring their corporate tax payments, nor does it look to include the general administration costs to enforce the policy itself.

It was noted by Mr Christopher Burrell, Managing Director, Burrell Stockbroking & Wealth Management during the hearing that the special franked dividend being contemplated as part of the Newmont and Newcrest merger would be at risk if the proposed legislation in Schedule 5 were to be implemented. Looking at this transaction in particular, with reference to the $10 million per annum forward estimates of Schedule 5, please see below the anticipated value payable to shareholders under the proposal (including the special fully franked dividend):

[1] Australian Tax Office: Taxation Statistics 2019-20

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Special Dividend (USD)	$	1.10	
AUDUSD		0.667	
Special Dividend (AUD)	$	1.65	
NCM shares on issue		894,230,732	
Exchange ratio		0.4	
Newmont equivalent		357,692,293	
Total franked dividend value (A$mn)		1,475	
Newmont closing price (USD)		52.05	
Equity value of shares (US$mn)		18,618	
Equity value of shares (A$mn)		27,913	
Plus franked dividend (A$mn)		1,475	
Total value (A$mn)		29,388	**Reconciles with the A$29.4 billion in ASX release*

As set out above, the transaction includes a $1.475 billion fully franked special dividend. In applying the proposed legislation, which would deny the distribution of the associated franking credits to shareholders as part of the special franked dividend according to Mr Burrell, the associated value is $632 million and as a single transaction alone, this well exceeds Treasury's $10 million per annum forward estimates and highlights the fundamental flaws in their analysis and modelling.

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Response to Senator O'Neill

Senator O'Neill – With your expert hat on, Mr Wilson, what sort of redrafting of schedule 5 would address the mischief that has been discussed to date?

Please note – as part of the line of questioning, Jesse referred to providing amendments of schedule 4 as well.

Proposed amendments to schedule 4: Off-market share buy-backs

Referring back to Wilson Asset Management's Senate Inquiry submission, to make this legislation logical for the capital management and restructure of businesses in the future, we suggest the removal of the following from the proposed legislation:

- *Schedule 4, Subsection 205-30 (1) Section 9A; and*
- *Schedule 4, Subsection 205-30 (1) Section 9B;*

The current drafting suggests that companies, which in the future may use a legitimate off-market share buy-back as part of a restructure/re-capitalisation, will lose part of their franking account balance or be forced to pay a franking deficit tax if it has retained earnings or other reserves in its balance sheet. These companies will permanently lose the amount of franking that previously would have been distributed to shareholders under an off-market share buy-back, even though under this proposed legislation the buy-back price cannot be franked.

We believe these changes to the proposed legislation, at a minimum, are essential to ensure the integrity of off-market share buy-backs as an efficient capital management initiative for corporate Australia in the future. The changes proposed leave Treasury's proposal undisturbed (including the $550 million of revenue in the forward estimates) and are simple refinements to restore the integrity of utilising off-market share buy-backs as part of restructures or recapitalisations that do not involve the payment of franked dividends.

Proposed amendments to Schedule 5: franked distributions funded by capital raisings.

We strongly recommend the complete removal of Schedule 5 from the draft legislation.

Agreement to remove, or significantly redraft, Schedule 5 was evidenced in the submissions, and subsequently reinforced in the 2 May hearings, by tax experts, lawyers, academics and industry experts.

The following expert witnesses agree with our concerns around Schedule 5 and that it be completely removed, or substantially redrafted, to remove the substantial unintended consequences that its current drafting will have on Australian companies, Australian shareholders and the Australian economy:

- **BYRNE, Mr Justin, Chair, Taxation Committee, Law Council of Australia**
- **CHENG, Mr Julian, Tax Partner, Gilbert + Tobin**
- **CLEMENTS, Mr Andrew, Senior Consultant, King & Wood Mallesons, and Member, Taxation Committee, Law Council of Australia**

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- **SHERMAN, Mr Tim, Partner, Tax Group, King & Wood Mallesons**
- **BARBOUR, Mr Michael, Group Head of Tax, Chair Bank, Australian Banking Association**
- **TAYLOR, Mr Christopher, Chief of Policy, Australian Banking Association**
- **ABDALLA, Ms Julie, Senior Tax Counsel, The Tax Institute**
- **CROKER, Mr Michael, Tax Leader, Australia, Chartered Accountants Australia and New Zealand**
- **LIEW, Ms Karen, Senior Tax Advocate, Chartered Accountants Australia and New Zealand**
- **TREATT, Mr Scott, General Manager, Tax Policy and Advocacy, The Tax Institute**
- **BALZER, Ms Fiona, Policy and Advocacy Manager, Australian Shareholders Association**
- **STRANDQUIST, Mr Wayne, National President, Association of Independent Retirees**
- **WATERHOUSE, Ms Rachel, Chief Executive Officer, Australian Shareholders Association**
- **BROWN, Professor Christine, Private capacity**
- **DAVIS, Professor Kevin, Private capacity**
- **NICOL, Professor Robert, Private capacity**
- **PARTINGTON, Mr Graham, Private capacity**
- **WILSON, Mr Anthony, Head of Equities, Shaw and Partners**
- **BURRELL, Mr Christopher (Chris), Managing Director, Burrell Stockbroking & Wealth Management**

If the Senate continues to move forward and legislate, it should be limited to the Taxpayer Alert (TA) 2015/2 *Franked distributions funded by raising capital to release franking credits to shareholders* as published on 7 May 2015.

The proposed amendments address the instances of mischief that were identified at the time the TA was issued and provides clarity to the circumstances in which the legislation would apply and acts as a clear anti-avoidance measure as intended by Treasury. The following amendments have been drafted to replace the current text in the draft legislation in Schedule 5, Subsection 207-159.

Schedule 5, Subsection 207-159 Distributions funded by capital raising.

This subsection applies to a franked distribution of any kind made by an entity if all of the following conditions are satisfied:

a) *A company with a significant franking credit balance raises new capital from existing or new shareholders by way of a fully underwritten offer. This may occur through offering an underwritten renounceable rights issue to shareholders or an underwritten dividend reinvestment plan. Shareholders may include large institutional superannuation funds.*

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b) *At a similar time to the underwritten capital raising, the company makes franked distributions to its shareholders, in a similar amount to the amount of capital raised. This may occur as a special distribution paid to shareholders and overall:*

   i. *there is minimal net cash inflow to or outflow from the company;*
   ii. *the net asset position of the company remains essentially unchanged, but their franking account is significantly reduced, and*
   iii. *there is minimal impact on the shareholders, except in some cases they may receive refunds of franking credits.*

c) *The franked distributions may be unusually large compared to ordinary distributions previously declared and paid by the company (as distinct from a typical distribution reinvestment plan applicable to an ordinary regular or special distribution paid in the ordinary course).*

d) *The franked distribution may be receivable by all existing shareholders of the company, or shareholders may have a choice as to whether to participate (for example, in a renounceable rights issue).*

For reference, the details of TA2015/2 published in 2015 can be found here and have formed the basis for the proposed amendments:
https://www.ato.gov.au/law/view/document?DocID=TPA/TA20152/NAT/ATO/00001&PiT=99991231235958#:~:text=This%20Alert%20provides%20a%20summary,currently%20have%20under%20risk%20assessment.

Should Treasury or the Government be minded to add in further clarification points in addition to the above proposed amendments they can be included as subsections to the legislation and should remain directed at the items identified in TA 2015/2 which went to great lengths in eliminating all instances of mischief the Australian Taxation Office (ATO) and Treasury were looking to remove, as confirmed by the ATO when they concluded in 2021 that the instances it highlighted in its 2015 TA are, “no longer prevalent in the large public and multinational business population”.

Any further extension of the proposed legislation again will create uncertainty and the potential for significant unintended consequences, beyond addressing the examples of mischief Treasury and the Government are trying to stop reoccurring.

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