

Senate Standing Committee on Economics
ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Inquiry into Treasury Laws Amendment (2023 Measures No. 1) Bill 2023

Division: Corporate and International Tax Division
Topic: TLAB Measures No. 1 - Schedule 5
Reference: Written
Senator: Andrew Bragg

Question:

1. What is your view of list of legitimate situations submitted by Wilson Asset Management – and whether they will satisfy ‘established practice’ test (page 9 of Wilson Asset Management submission).
2. What is the expected immediate and longer-term impact of schedule 5 on private companies?
3. Please provide data for the last 5 financial years on the franking balances of Australian private companies.
4. Has Treasury modelled the impact on corporate financing decision-making by section 207-159?
5. What do you expect section 207-159 to achieve in practice?
6. What will be the practical impact of the application of section 207-159 for all stakeholders after a franked dividend has been paid?
7. What does the Treasury consider “significant level of connection between entities” as stated in 5.26 of the EM?
8. Is section 207-159 more likely to be invoked by the ATO where financing arrangement favours shareholders who enjoy comparatively low tax rate?
 - a. Why are existing legislation safe-guards inadequate?
 - b. Is this another self-assessed anti-avoidance provision - alleviating the burden on the ATO?
9. What are the second order and third order assumptions that underpin the Treasury’s costing of the measure?
10. What are the behavioural effects of schedule 5? Has the Treasury modelled this?
11. How will Schedule 5 affect the capital structures of Australian companies?
12. How many companies in the 2021-22 distributed franking credits that were funded by capital raising activities? How does this compare to 2020-21 and 2015-16 and 2016-17

Answer:

1. There are situations where companies may not have an established practice of paying a dividend, for example newly established companies or companies with irregular profits. The Bill includes a list of factors to be considered when determining whether the established practice test is met, including any explanations given by the entity for making the distribution and any other relevant consideration. This could include, for example, where a company has a commercial reason for changing its dividend practice or where a company follows an established dividend practice, but its dividends vary in timing and quantum due to the volatility of its profits.

Additionally, arrangements will not be captured by the measure simply because they do not satisfy the ‘established practice’ test. The issuance of the relevant equity interest must also have both the ‘effect and purpose’ of directly or indirectly funding all or part of the relevant distribution.

2. This measure does not differentiate between private and public companies.

The ATO issued TA2015/2 in response to behaviour of concern by a small number of companies.

Subsequently, and following the announcement of this measure by the former Government in the 2016-17 MYEFO, the ATO has not observed taxpayers engaging in this behaviour in any significant way. This suggests that the vast majority of both public and private companies were not engaging in the behaviour targeted by this measure, and companies have been complying with the measure since it was announced. Therefore, we expect the vast majority of companies, including private companies, will continue to be unaffected by the measure.

3. Relevant data is set out below.

Year	Total franking account balances of Australian resident private companies (\$b)
2015-16	188.7
2016-17	202.1
2017-18	216.7
2018-19	229.0
2019-20	259.7

Source: Australian Taxation Office (ATO) Taxation Statistics 2015-16 to 2019-20, “Companies: Selected items, by taxable status, residency status, company type and company size”

The relevant statistics in ATO Taxation Statistics were sourced from company income tax returns for each income year, processed by 31 October of the year following the end of the income year. For example, data for the 2019-20 income year includes data processed up to 31 October 2021. This means the statistics for 2020-21 and 2021-22 are not yet complete. Where residency status is not stated, the company is classified as a non-resident.

4. Treasury has not modelled the impact on corporate financing decision making, which is a second-round impact of the policy. Consistent with paragraph 3.5 of the Budget Process Operational Rules, only first-round effects were considered as part of this costing.

The Bill is not expected to impact companies' financing decisions. As noted in the answer to question 2, the vast majority of companies were not engaging in the behaviour targeted by this measure, and companies have been complying with the measure since it was announced. The Bill does not prevent companies from raising capital for commercial purposes, including paying dividends in accordance with a company's ordinary dividend policy.

5. Section 207-159 aims to prevent entities from manipulating the dividend imputation system to facilitate the release of franking credits not in accordance with the intended operation of the dividend imputation system. Section 207-159 will prevent the use of artificial or contrived arrangements under which equity is raised for the purpose and principal effect of releasing franking credits.

The targeted behaviour has not been observed significantly since the ATO issued TA2015/2 and the subsequent 2016-17 MYEFO announcement, indicating the Bill will deter companies from engaging in such behaviour.

6. When the provision applies, the distribution is treated as un-frankable.

This means companies' franking account balances would remain unchanged and any dividends paid to shareholders as a result of a capital raising within the scope of this measure would be unfranked. Shareholders would continue to receive the benefit of the distribution but not the franking credit.

7. In order to prevent entities from circumventing this measure by raising capital through one entity and making a distribution through another entity, the provisions apply to arrangements undertaken by multiple entities. Paragraph 5.26 of the explanatory memorandum provides that "typically in arrangements to which the amendments apply there will be a significant level of connection between the entities".

What constitutes a "significant level of connection between the entities" would depend on the relevant facts and circumstances. Without limiting the application of the amendments, an example of a significant level of connection would be where one entity has control over another entity.

8. No. The measure's application does not depend on the marginal tax rates of the shareholders receiving the franked distribution.

- 8.a. Existing legislation is not adequate.

Specific anti-avoidance provisions contained in the general anti-avoidance rules (Part IVA of the Income Tax Assessment Act 1936) were drafted in the context of concerns with other types of behaviour that may reduce the integrity of the imputation system, including dividend streaming and franking credit trading, creating uncertainty as to their interpretation when being applied to the practices outlined in the ATO's TA2015/2.

- 8.b. More generally, Part IVA does not apply to tax benefits received as a consequence of the receipt of franking credits. The measure is self-executing, meaning it applies automatically.

Following the 2016 MYEFO announcement, stakeholders expressed a preference to Treasury for a specific self-executing rather than an anti-avoidance provision applied at the determination of the Commissioner. Stakeholders considered that a specific provision in the law would reduce uncertainty, as companies would be better placed to judge whether their proposed arrangements were subject to the provision before the arrangements were finalised and executed.

9. Consistent with paragraph 3.5 of the Budget Process Operational Rules, only first-round effects were considered as part of this costing. The costing did not incorporate any second- and third-round impacts.
10. Treasury's costing of the 2016-17 MYEFO measure assumed that companies would respond by ceasing to distribute franked dividends that are directly funded by capital raisings, consistent with the policy intent.
11. The Bill is not expected to impact the capital structures of Australian companies.

As noted in the answer to questions 2 and 4, the vast majority of companies were not engaging in the behaviour targeted by this measure, and companies have been complying with the measure since it was announced. The Bill does not prevent companies from raising capital for commercial purposes, including paying dividends in accordance with a company's ordinary dividend policy.

12. Since the original announcement of the measure in 2016, there has been no confirmed activity linked to franked distributions funded by capital raisings.