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: Large business advantages
Reference: Spoken (p. 64-65)
Senator: Nick McKim

Question:

Senator McKIM: You both very presciently answered my next question. I'd like Treasury and the ATO to both respond to this. Would you agree or disagree with the contention that, taken as a whole, schedule 5 would tend to give larger, more well established companies a competitive advantage over newer, less well established companies?
Ms Bultitude: The legislation is designed to capture what was a very small number of behaviours undertaken that gave rise to the taxpayer alert, so it's difficult to say that it's going to be putting a whole class of companies at a disadvantage to another class of companies when it's a relatively small number of transactions or behaviours that are being captured by this legislation. The vast majority of companies, small and large, will be unaffected because they're not engaging in this type of behaviour.
Senator McKIM: Just to be clear, I'm suggesting that, because smaller, newer companies are more reliant on equity funding compared to larger, more well established companies and because smaller, newer companies are less likely to have an established practice of issuing franked dividends, that may result in a situation whereby larger, more well established companies have a competitive advantage over smaller, less well established companies. I just want to be clear about the proposition I'm putting. Thank you for your response. Perhaps you could have a think about that and, if you have anything further in response to that, you could come back to the committee on notice.
Ms Bultitude: I'm happy to do that.

Answer:

Schedule 5 is not intended to provide a competitive advantage to larger more established companies over smaller less well-established companies. It would prevent companies of any size from entering into artificial and contrived arrangements to raise capital for no commercial purpose and use this capital to fund franked dividends to shareholders.

We do not believe that the legislation will prevent small companies from paying dividends in ordinary commercial circumstances and so should not have any effect on their cost of capital or competitiveness with larger companies. As indicated below, not having a practice of making regular distributions does not of itself mean that the dividends will be un-frankable.

<u>Established Practice test</u>

Schedule 5 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.

While new start-ups may not be able to satisfy the established practice test initially, 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 dividend payment. This means arrangements will not be captured simply because they do not satisfy the 'established practice' test.

Debt v Equity

Schedule 5 is not designed to interfere with a company's ability to choose between debt or equity financing to fund its operations. The measure applies in circumstances where the funds raised are not intended to be retained by the company.

Schedule 5 would apply – in specific circumstances – to companies that raise capital just to release unused franking credits to shareholders.

It does not prevent companies from raising capital for commercial purposes, including paying ordinary dividends in accordance with their regular dividend policy or special dividends that have a commercial purpose (other than to distribute franking credits).

There has been minimal activity associated with franked distributions funded by capital raising observed by the ATO since the measure's announcement in 2016. This is consistent with taxpayers changing behaviour in response to the retrospective start date as announced in the 2016-17 MYEFO.

- This implies that the majority of companies – large and small – are likely to be compliant with the measure. The ATO's Taxpayer Alert TA 2015/2 set out a number of features common in the arrangements that were identified as giving rise to the concerns outlined in the Taxpayer Alert. One feature noted was that the arrangements may be entered into by companies that had large institutional superannuation funds as members.