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31st March 2023

To the Secretariat
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
Email: seniorclerk.committees.sen@aph.gov.au

Dear Sir/Madam,

RE: SUBMISSION FOR INQUIRY INTO TREASURY LAWS AMENDMENT (2023 MEASURES NO. 1) BILL 2023 (PROVISIONS) - Schedules 4 & 5

The proposed measures appear to add complex and uncertain provisions to the franking legislation. They appear to be a backdoor method to achieve certain outcomes which have failed due to push back against the previous election proposals by Mr. Bill Shorten in respect to changing the franking credit regime.

The franking system in Australia is superior to the classical system in the USA and other places.

The franking system means that companies are able to pay dividends which are franked to the extent that the company has paid underlying tax, so providing a mechanism whereby double tax at both the company and the individual taxpayer level is avoided.

The franking system is not only equitable, but leads to higher dividends which averages 4-5% for Australian listed companies and this provides more adequate levels of income for retirees.

The system is also efficient with respect to the allocation of capital because having paid out higher dividends, if a company then requires additional funds for a new venture, they come to the market with a proposal and shareholders and intermediaries evaluate the proposal and may assist with the funding of that proposal via placements, share purchase plans etc.

The franking system compares to the classical system in the USA. Because the dividends are taxed at both the company and individual level in the USA, companies pay low dividends, on average – 1-2%, leading to higher retentions. A deal of those funds are then wasted on a higher executive re-numeration and high price takeovers. The US system is far less efficient in the allocation of capital to attract new ventures.

We are aware of discussions from past years that there are those in Treasury that see the classical system as leading to higher investment because the companies retain more funds. In our view, the benefits from the implementation of franking in Australia far out-weigh the negatives from the classical US system.

SCHEDULE 4 – Off-market share buy-backs

NO part of the off market share buyback can be taken to be dividend.

The mischief which is sought to be addressed with off market buybacks is that because companies have utilized their franking accounts to frank the buy back, and because low income taxpayers including superannuation funds receive a refund of excess franking credits, there is a clientele affect whereby franking credits are more valuable to those entities.

Accordingly capital is raised on average at a 14% discount and without significant placement fees, in return for which the low tax paying entities receive a refund in whole or in part of the franking credits.

If that is the mischief to be addressed, then a simple way to deal with this is to provide that entities other than individuals including superannuation funds are not entitled to a refund of excess franking credits.

Instead of addressing this mischief, the proposed legislation seeks to provide that no part of an off market share buy back share can be taken to be a dividend. This provision seems an over reach and likely to lead to unintended consequences. The explanatory memorandum said it is to bring off market buy backs into line with on market buy backs. The only reason that no part of a market buy back market is a dividend, is that the company declares no dividend and the transaction from the view point of the seller of the shares on market is a capital transaction.

In summary, we are not convinced that the legislation is necessary or good legislation as it seeks to achieve an unstated result by obscure means.

Schedule 5/Chapter 5 Franked distributions funded by capital raisings

This section is definitely undesirable as it seeks to provide that unless there is an established pattern of distributions, then a franking entity cannot frank that distribution. There seems to be some perceived evil in Treasury that is not at all clear to us. If it is that some anti-avoidance mechanism is required to deal with some perceived scheme, then that is the form that the legislation should take.

The new law however, goes considerably beyond that and says that if a distribution is not consistent with an established practice i.e. it is not a regular dividend, then it's unfrankable, if there is a capital raising associated in any way. This uncertain legislation is likely to have unintended consequences and result in significant consultanting fees because of the uncertainty.

For example, dividend reinvestment plans are a legitimate way to deal with different shareholders clientele effects. Some shareholders require franked dividends to live on e.g. those in retirement. Other shareholders are happy to reinvest their dividends, but they are shown as franked dividends on their tax returns as if they have received the cash. There is therefore no mischief, in a dividend reinvestment plan which allows franked dividends to be declared, but some shareholders to reinvest and others to elect to take cash. That is an ordinary business or commercial dealing. Yet that ordinary business or commercial dealing is placed in jeopardy by the proposed legislation.

Schedule 5 Franked distributions funded by capital raisings fails the usual tests of certainty, equity and clear purpose. As such Schedule 5 Chapter 5 should definitely not be proceeded with.

Thank you for the opportunity to make this submission.

Yours truly

[redacted]

Chris Burrell
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