17 June 2013

Manager
Corporate Tax Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Via Email: dividendwashing@treasury.gov.au

Dear Sir/Madam,

Preventing Dividend Washing

The Australian Financial Markets Association (**AFMA**) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers.

We welcome the opportunity to provide a submission to Treasury regarding the Discussion Paper entitled "Preventing Dividend Washing" (**the Discussion Paper**).

AFMA's Preferred Position

As is noted in the Discussion Paper (at Paragraph 20), the" 45-day rule," which generally needs to be satisfied by an investor seeking to claim franking credits, has been repealed from the *Income Tax Assessment Act 1936* (**1936 Act**) but has not been enacted in the *Income Tax Assessment Act 1997* (**the 1997 Act**). Hence, the 45-day rule operates by virtue of Sections 207-145 and 207-150 of the 1997 Act, which provide that an entity is not entitled to a tax offset where the entity would not be a qualified person when determined with reference to the "former Part IIIAA" of the 1936 Act.

AFMA believes that this position is sub-optimal and the clearly preferable method to amend the 45-day rule is through legislation encapsulated within the dividend imputation provisions of the 1997 Act, as opposed to amending repealed law. Accordingly, it is AFMA's recommendation that Treasury should see the requirement to amend the 45-day rule as the catalyst for ensuring that the imputation provisions contained in the 1997 Act are self-executing and not reliant on repealed law. That is, if any legislative amendment is required, such an amendment re-writes the 45-day rule into the 1997 Act.

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In terms of the appropriate legislative solution, AFMA's preference is that any concerns with dividend washing be addressed through the definition of "qualified person." For example, the former Section 160APHO could be amended to reflect that:

> "A taxpayer is not a qualified person in relation to a particular distribution if the shares or interests in shares on which the distribution is paid were acquired on or after the date on which the shares went ex-dividend and substantially identical shares were disposed of in the three day period commencing on the day on which the shares went ex-dividend."

This would apply from 1 July 2013.

Noting our comments above regarding the need for the 45-day rule to be written into the 1997 Act, we legislative that any interim measure should directly address the specific concerns and mitigate the risks of unintended consequences for legitimate trading activities. We submit that a change such as that noted above would be consistent with these objectives.

Section 3.2 of the Discussion Paper sets out a proposal to modify the Holding Period rule by deeming shares that are acquired after the ex-date on a cum-dividend basis to be deemed to have been acquired prior to the sale of the ex-dividend shares. This would allow the LIFO rule that exists in the holding period rules to deem the shares that were acquired in the cum-dividend market to be the same shares sold on or after the ex-date and hence not have been held sufficiently at risk for a 45-day period. The concern we have with this approach is that it may give rise to unintended consequences and unnecessarily capture legitimate transactions as being construed as "dividend washing." These may include:

- trade fails where a seller needs to acquire shares to deliver on a cum-dividend basis and does so through utilising the special cum-dividend market;
- securities lending transactions where a borrower of shares who has on-lent those shares does not receive the shares back in time to redeliver to the original lender and utilises the special cum-dividend market to acquire shares to settle the securities lending arrangement; and
- transactions between buyers and sellers who are both able to claim the franking credits.

Importantly, many market participants determine their entitlement to franking credits utilising computer systems that have been developed based on the existing rules. Any changes would erode the effectiveness of these systems and result in significant operational and compliance costs. A targeted solution such as that set out above, as opposed to a change to the LIFO rule, would appear to mitigate such costs.

Amendments to Part IVA

Section 3.3. of the Discussion Paper canvasses an option of amending Part IVA, and specifically amending Section 177EA(17) to "highlight that the timing of the trades is a relevant factor when determining if a scheme was designed with a tax avoidance purpose."

It is AFMA's strong view that this option should not be pursued. Due to difficulties associated with self-assessing Part IVA, amendments to Part IVA necessarily operate on a retrospective basis and with a large degree of uncertainty. This is especially the case in the current context where the Bill that will significantly amend Part IVA is before the Senate and, once enacted, the body of judicial precedent that currently exists as to the

interpretation of the provisions will soon be redundant. This is relevant as, in applying Section 177EA, the Commissioner must take into account the circumstances set out in Subsection 177EA(17), which includes a wide range of circumstances, including, amongst others, the criteria set out in Section 177D of the ITAA 1936, i.e. the provisions that are to be amended.

Such uncertainty and retrospectivity gives rise to a number of practical difficulties. For example, by the time that a Part IVA assessment is issued by the Commissioner, a fund may have distributed the franking credits to its beneficiaries that it believed were entitled to be claimed. In such a circumstance, penalising the trustee of the fund, or making each beneficiary subjected to amended assessments, would appear sub-optimal from an administration perspective.

AFMA's preference is for an amendment that is clear, self-executing and targeted.

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We believe our submission addresses the General and Specific questions set out in the Discussion Paper; however please contact me on (02) 9776 7996 or at rcolquhoun@afma.com.au if you would like to discuss any aspects of the foregoing.

Yours sincerely

Rob Colquhoun
Director, Policy (Taxation)