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Manager
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17 June 2013

Dear Sir/Madam

DISCUSSION PAPER - "PREVENTING DIVIDEND WASHING"

BDO welcomes the opportunity to provide a submission on the discussion paper (Discussion Paper) *Preventing dividend washing,* released by Treasury for public consultation on 3 June 2013.

We make the following submissions in respect of the matters raised in the Discussion Paper:

Use existing anti-avoidance rules

We query the need for additional specific provisions to counter the "mischief" of dividend washing. The current specific anti-avoidance rule in section 177EA of Part IVA of the Income Tax Assessment Act 1936 (ITAA 1936) should be sufficient to deny the additional franking credits in most if not all situations as described in the discussion paper. We, in particular, note that the identification by the Commissioner of Taxation (the Commissioner) of the relevant taxpayers is simplified by the capacity of the Commissioner to serve notice of him making a determination under paragraph 177EA(5)(b), in respect of a distribution by a listed public company, by causing a notice to be published in a daily newspaper that circulates nationally (see subsection 177EA(7)).

The Discussion Paper proposes to add a further criterion in subsection 177EA(17) of Part IVA to highlight that the timing of trades is a relevant factor when determining if a scheme was designed with a tax avoidance purpose. While we think the existing criteria in subsection 177EA(17) would be sufficient for the operation of section 177EA in these circumstances, we would not disagree with inserting the additional criterion.

Alternatively, if section 177EA was ineffective in this regard, the Commissioner could determine the general anti-avoidance rule in Part IVA applies. We see that it would be very difficult for a taxpayer receiving additional franking credits in the situation described in the discussion paper to successfully argue the scheme was not entered into with the dominant purpose of obtaining the tax benefit of the additional franking credits.

We suggest that rather than add even more complexity to the income tax law by introducing additional specific anti-avoidance provisions, the Australian Tax Office (Tax Office) should look for a suitable test case to take to the courts to confirm the effectiveness of the current Part IVA in these situations. The

success of such a test case should be sufficient to protect the revenue from further erosion from such arrangements.

If the government thinks a further deterrent is required the Tax Office has the promoter penalty provisions it could implement to discourage promotion of these arrangements.

Specific amendment the holding period rules

If the Government decides amendments (beyond those addressed above, in respect of subsection 177EA(17)) are required to counter the dividend washing arrangements, as the "mischief" to be addressed is a specific, narrowly defined behaviour, the measures addressing such mischief should be, similarly, narrowly focussed. Accordingly, the most appropriate method of addressing "dividend washing" would be the inclusion of suitable provisions in the proposed rewritten version of the "holding period rules" to be incorporated into the *Income Tax Assessment Act 1997* (ITAA 1997), as addressed on page 6 of the Discussion Paper.

The modifications to the holding period rule should be targeted to the period after the share goes ex-dividend on a time and concept basis, in that the rules should only apply where shares are sold on an ex-dividend basis and, within the requisite time period, shares are subsequently acquired on a cum-dividend basis in respect of the same dividend.

Rewrite of holding period rules

The rewrite of the holding period rules from the repealed Division 1A of Part IIIAA of ITAA 1936 into the ITAA 1997 should be expedited, as the current reference to such repealed rules in s207-145(1)(a) and s207-150(1)(a) of the ITAA 1997 causes unnecessary uncertainty about the status of such provisions.

Specific new anti-avoidance rule in Part IVA

The inclusion of a specific dividend washing rule in Part IVA is our least preferred position. Part IVA should, as much as is reasonably possible, be reserved for anti-avoidance rules of general application rather than more narrowly focussed anti-avoidance rules. As mentioned above we see the current Part IVA rules should be sufficient to counter these arrangements, and therefore the proposals that a specific anti-avoidance rule addressing "dividend washing" be incorporated into Part IVA as the primary measure, or as a complementary measure, should not be adopted.

Conclusion

Our preferred position is for no legislative amendment before allowing the Tax office to test the application of the current Part IVA and promoter penalty provisions to counter these dividend washing arrangements. The insertion of additional specific anti-avoidance rules before the Tax Office has tested the existing rules in the courts could be seen as trying to fix a problem that may not exist.

However, if it is decided that legislative amendment is required it should be in the form of either the contemplated amendment to subsection 177EA(17) or, alternatively, amendments to the 45 day holding

period rule, which would require the expediting of the rewrite of the 45 day holding period rules into the ITAA 1997.

Should you have any questions, or wish to discuss any of the comments made in the above submissions, please do not hesitate to contact Lance Cunningham on 02 9240 9736 or lance.cunningham@bdo.com.au or Matthew Wallace on 02 9240 9760 or matthew.wallace@bdo.com.au.

Yours sincerely

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