

16 May 2014

General Manager
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: corporations.amendments@treasury.gov.au

Dear Sir/Madam

Exposure draft – Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014

CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) welcome the opportunity to comment on the exposure draft legislation (ED) and accompanying explanatory material (EM) for the proposed amendments.

CPA Australia and the Institute represent over 210,000 professional accountants in Australia and abroad. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

Our general comments are as follows with more detailed comments within the Appendix.

Overall, we support the ED as we consider it will improve the effective operation of the Corporations Law. In particular, the removal of the link to the accounting standards in relation to the dividends test will have a positive impact for a large number of organisations.

Our concerns relate to the operation of the dividend provisions and their taxation implications, as well as the increased disclosure in respect of the remuneration framework.

Dividend provisions

Our first issue relates to the proposed Section 254TA. As currently drafted, section 254TA may limit the ability of a company to pay a dividend that results in a reduction of share capital in situations where there are on issue shares other than ordinary shares with a priority right to dividends e.g. preference shares. The equal reduction requirement in section 254TA only authorises the reduction of share capital to fund dividends in relation to ordinary shares. So if a company has on issue both ordinary shares and preference shares (the terms of which entitle them to dividends in priority to ordinary shareholders), the company may not be able to take advantage of section 254TA. We recommend that this issue be addressed.

Representatives of the Australian Accounting Profession



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We also observe that the term 'ordinary shares' is not defined in the Corporations Law. This may make it difficult for private companies which often have more than one class of shares or shares which carry discretionary rights, for example to dividends, to determine which are ordinary shares (if any) for the purposes of section 254TA. If shares are not determined to be ordinary shares then we note that they cannot take advantage of section 254TA. We request guidance in the Explanatory Memorandum (EM) relating to such circumstances.

The third issue relates to the requirement for the directors to include details about the source of dividends when paid other than out of profits. Determining whether a dividend is funded from profits or capital is not always clear cut, and the move away from difficulties posed by the determination of 'profits' was part of the reason for the move to the solvency based test three years ago. We also consider that the financial statements will clearly disclose how the dividend has been accounted for, and hence the requirement for disclosure in the directors' report seems to create additional unnecessary clutter. Our preference is for such a disclosure requirement to be removed. In its place we would accept disclosure of an entity's dividends policy, as this would seem to meet the integrity measure referred to in the EM.

We are disappointed that our earlier recommendation of a 'transitional no prejudice' rule for directors was not included in this ED. We requested this to be considered in the event that directors may have paid dividends on the basis that existing section 254T authorised the payment of dividends out of capital. We considered this was an appropriate request given the intention of the 2010 amendments and the differing views which have subsequently emerged in relation to their effect.

Taxation implications

In relation to tax, we acknowledge the statement in the EM that the proposed changes to the Corporations Act are not designed to change the taxation arrangements for dividends.

We previously highlighted a number of taxation issues that have arisen from, or were exacerbated by the 2010 amendments, which ideally should be considered prior to finalising any amending bill.

We remain of the view that some consequential tax law changes may be required. At the very least we envisage the need to update the legislative references in the existing tax guidance.

We consider that there should be a short consultation process on the taxation interactions, which may involve both the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission, with a view to developing a position on the guidance that the ATO should give. The EM could make reference to that process.

Remuneration Framework disclosure

As highlighted in our previous submission on this issue, we do not support the requirement to include a general description of a company's remuneration governance framework in the remuneration report. We consider this requirement duplicates part of that already existing in the Corporations Law, and also the requirement contained in the recently issued ASX Corporate Governance Principles.

Further, we believe a bigger benefit for red-tape reduction in relation to remuneration reporting has not been addressed by this ED. We consider there are significant deregulatory opportunities to simplify and streamline current remuneration reporting and we would like to see a more fulsome proposal on this, rather than adding additional disclosures in the interim.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au or Kerry Hicks (the Institute) at Kerry.Hicks@charteredaccountants.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Alex Malley', with a long horizontal flourish extending to the right.

Alex Malley
Chief Executive
CPA Australia Ltd

A handwritten signature in black ink, appearing to read 'Lee White', with a long horizontal flourish extending to the right.

Lee White
Chief Executive Officer
Institute of Chartered Accountants in
Australia

Appendix

Dividends test amendments

We welcome the proposed amendments which propose a pure solvency test without any link to accounting standards. This will remove the compliance burden on companies that are not otherwise required to apply accounting standards (for example, small proprietary companies).

In previous submissions we supported the additional net assets limb to the test which is included in the New Zealand solvency test. Our support for this was based on our support for the Trans-tasman agreement between the governments of the two countries in relation to harmonisation of corporate law requirements. Whilst in our view this is still an important objective, we are uncertain as to the government's position on these previous arrangements. Therefore, we would accept a pure solvency test, as this keeps some similarity with the New Zealand test without putting any unnecessary compliance obligations on Australian business.

However, we remain concerned that, from a Corporations Law perspective:

- Companies may be required to amend their constitutions to enable them to pay dividends from capital with the consequent costs that this entails.
- The current drafting of section 254TA may prevent a company paying a dividend on ordinary shares that results in a reduction of share capital in situations where there are other shares on issue with priority dividend rights e.g. preference shares.
- The requirement to detail the source of dividends creates unnecessary clutter in the directors' report.

Authorising provision

In our previous submissions we recommend that section 254T be drafted as an authorising provision rather than a prohibitive provision to overcome a view that dividends were still required to be paid out of profits.

We understand from legal commentators that the combined effect of proposed sections 254T and 254TA should allow dividends to be paid out of capital providing the requirements of those sections are satisfied. However, as drafted the proposed amendments do not override a company's constitution which may require dividends be paid only out of profits or only where net assets remain positive after the payment.

This means that some companies are unable to take advantage of the proposed amendments without amending their constitutions with the consequent costs which this entails. We recommend that Treasury considers if there is a way of drafting the provisions to ensure that the provisions override a company's constitution unless the company chooses otherwise.

If proposed section 254T remains unchanged we recommend that the EM to the amending bill specifically states that the Corporation Law does not override a company's constitution.

Section 254TA

Section 254TA only authorises the reduction of share capital to fund dividends in relation to ordinary shares. So, if a company has on issue both ordinary shares and preference shares (the terms of which entitle them to dividends in priority to ordinary shareholders), in the absence of profits sufficient to fund a dividend on preference shares, it would appear that the company could not take advantage of section 254TA to pay ordinary dividends or indeed preference dividends.

If the objective of the amendments is to allow companies which do not have profits but which are solvent to pay dividends on ordinary shares out of capital this outcome does not appear appropriate and should be addressed in finalising the bill. One option may be to amend section 254TA to allow dividends to be paid on shares with priority dividend rights when this accords with their terms of issue. There may be other more appropriate ways of achieving a similar outcome.

Disclosure of sources of dividends

The proposed amendments require directors to detail the source of dividends and the board's dividend policy in circumstances where dividends are paid from sources other than out of profits. The EM explains these requirements as being an important integrity measure to ensure that shareholders have the information they need about a company's dividend policy to make informed investment decisions.

However, the circumstances in which a dividend is being paid out of profits or capital is not always clear cut and the move away from difficulties posed by the determination of 'profits' was part of the reason for the move to the solvency based test three years ago. However, 'profits' is still an important determinant in relation to determining whether a dividend is franked. The joint opinion of Messrs AH Slater QC and JO Hmelnitsky obtained by the ATO in connection with Tax Ruling 2012/5 deals with the tax consequences of existing section 254T (and with which the ATO does not entirely agree). Indeed, there remains controversy amongst commentators over whether distributions to shareholders may be sourced other than from profits or capital.

We consider that the financial statements will clearly disclose how the dividend has been accounted for and hence the requirement for disclosure in the directors' report would simply seem to create additional unnecessary clutter.

Our preference is for such a disclosure to be removed. In its place we would accept disclosure of an entity's dividend policy and are happy to consult further on the details, as this would seem to meet the integrity measure referred to in the EM. If further guidance was required on the nature of such a disclosure, this could be achieved through an ASIC guidance note, if ASIC was not satisfied with the sufficiency of the information disclosed.

Income tax interactions

We acknowledge that the proposed amendments are not designed to change the taxation arrangements for dividends.

Nevertheless, in our 15 March 2013 submission on the earlier ED, we made a number of observations which, with few exceptions, remain valid and we do not propose repeating them in detail here. It is sufficient to say that some consequential tax law changes may still be required, e.g. to deal with the impact of the 2010 amendments on corporate limited partnerships which were not dealt with at that time and which continue to be an issue; some tax law changes might be worth considering and some tax guidance will require updating, e.g. Taxation Ruling TR 2012/5¹, what constitutes a debit to a share capital account and streaming issues. At the very least we envisage the need to update the legislative references in the existing tax guidance.

We consider that there should be a short consultation process on the taxation interactions, which may involve both the Australian Taxation Office (ATO) and the Australian Securities and Investment Commission, with a view to developing a position on the guidance that the ATO should give. The EM could make reference to that process.

¹ TR 2012/5 Income Tax: section 254T of the Corporations Act 2001 and the assessment and franking of dividends paid from 28 June 2010.

Remuneration Framework disclosure

As highlighted in our previous submission on this issue dated 15 March 2013, we do not support the requirement to include a general description of a company's remuneration governance framework in the remuneration report.

We consider this requirement duplicates part of that already existing in the Corporations Law, and also the requirement contained in the recently issued ASX Corporate Governance Principles (issued 27 March 2013 and applicable from financial years commencing 1 July 2014). We believe it creates extra compliance burden for companies with no benefits for users.

We also consider that this could create additional burdens regarding the audit of the remuneration report. Currently this information may only be contained in the Corporate Governance Statement which is not required to be audited, and which for financial years commencing from 1 July 2014 can appear on the entity's website, rather than be reproduced in full in the entity's annual report. The proposed ED requires it to be included in the remuneration report, which will mean the information will need to be audited, and therefore result in an extra compliance burden for business.

Further, we believe a bigger benefit for red-tape reduction in relation to remuneration reporting has not been addressed by this ED. We consider there are significant deregulatory opportunities to simplify and streamline current remuneration reporting and we would like to see a more fulsome proposal on this, rather than adding additional disclosures in the interim.

Other amendments

We support the government's aims to improve the efficient operation of the Corporations Law, reduce compliance costs for business and benefit business productivity generally. We agree with all other amendments proposed.