General Manager
Corporate Governance and Reporting Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
Parkes ACT 2600

16 May 2014

Dear Sir/Madam

Submission on the draft Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014

Thank you for the opportunity to comment on the *Corporations Legislation Amendment (Deregulatory and Other Measures) Bill 2014* (the draft Bill). We support the draft Bill's objectives of streamlining the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act* 2001. We particularly support addressing issues surrounding the operation of the dividends test and the information provided to investors in the Remuneration Report and agree that legislative change is required to address these issues.

The proposed changes to the test for payment of dividends address some of the issues with the current requirements. However, some uncertainty still remains regarding the interaction between the test for payment of dividends in section 254T in the Corporations Act and the underlying common law profits test. Further legislative clarification would be helpful to address this issue and we have elaborated on this in our submission.

We agree with the proposals in relation to the remuneration report however our view is that more fundamental reform is needed in the area of remuneration reporting. The level of detail and complexity of existing requirements often leads to boilerplate disclosure and a lack of clear, concise, decision useful information for investors. We therefore welcome the opportunity to engage with you further on this issue, share our perspectives and work towards developing an enhanced disclosure framework for remuneration reporting in Australia.

Our detailed responses to each of the proposals are included in the Appendix.

We would welcome the opportunity to discuss our views. Please contact Jan McCahey on (03) 8603 3868 or Margot Le Bars on (03) 8603 5371 to discuss issues relating to accounting, financial reporting and remuneration disclosures, Andrew Wheeler on (02) 8266 6401 to discuss legal issues, or Wayne Plummer on (02) 8266 7939 to discuss taxation issues.

Yours sincerely

Jan McCahey
Partner

Public Policy and Regulatory Affairs

Appendix: PwC's comments on the specific proposals raised in the draft Bill

1) Removal of the 100 Member Rule (section 249D)

We agree with the proposal to remove the obligation to hold a general meeting on the request of 100 shareholders.

2) The test for the payment of dividends (section 254T)

The proposed amendments to the test for the payment of dividends are a positive improvement from the current requirements and the previous Bill proposals released on 14 December 2012. We agree that a move to a full solvency test is a practical approach that leverages the existing definition of 'solvency' within the *Corporations Act 2001* ('the Act'). In our view, it would be preferable to make some additional clarification amendments so as to avoid inconsistent application and interpretation.

(a) Proposed changes to the test

Adopting the current dividends test created a regulatory burden for companies that are not otherwise required to comply with Australian Accounting Standards, by expecting them to calculate assets and liabilities by reference to the accounting standards. There has also been some confusion in practice about when the test should apply if the Directors choose to "determine" a dividend in accordance with section 254U of the Act rather than "declare" it. In our view, the proposed new section 254T of the Act addresses these issues.

However, there remains a body of legal opinion[1] that common law only permits dividends to be paid out of profits, and that the proposed section 254T continues to place a restriction on the payment of dividends, rather than explicitly authorising dividends. This uncertainty arises from the negative language used by section 254T: "A company must not declare a dividend unless…". Consequently, for dividends made to shareholders of anything other than ordinary shares, the combination of common law and section 254T implies that a dividend would still always have to be sourced out of profit.

In our view this issue could be addressed by drafting section 254T positively, for example "A company may only declare a dividend if…", which would authorise, rather than restrict, the payment of a dividend. We note such positive language has been used in the proposed new paragraph 9.1 of the small business guide in Part 1.5 of the Act. To make it absolutely clear that there remains no common law profits test, we also recommend that a new section 254T(4) is inserted to state "A dividend may be declared or paid from profits, share capital or any other source".

We note the proposed new section 254TA gives limited modification to the common law profits test. This drafting suggests that for dividends paid on any other class of shares, e.g. preference shares, the provisions of Chapter 2J *Transactions affecting share capital* would still need to be followed if dividends are sourced other than from profit. If our proposed amendments to s254T in the above

[1] Legal opinion provided to the Australian Taxation Office by AJ Slater QC and J Hmelnitsky SC (in support of Taxation Ruling TR2012/5)

paragraph were made, then s254TA would not be required. In addition to the 'solvency' test, existing checks and balances for the payment of dividends in these circumstances would still include relative share class rights, directors' duties and oppression rules.

(b) New disclosure proposal

We understand that the intention of the 2010 amendment to the dividends test was that the profits test for payment of a dividend be removed. The proposed new disclosure requirement in section 300(1)(ba) continues to make reference to "...dividends..paid otherwise than out of profits.." which would appear to be inconsistent with the move to a solvency test and the intent to remove the profits test. We agree with the intended purpose of this disclosure, as described in the Explanatory Material, but in our opinion this can be achieved by requiring disclosure of a company's overall dividend policy in the Director's Report, without referring to "profits" or the "source of dividends".

If the reason that the current proposal makes reference to "source of dividends" is taxation related, (i.e. to assist in determining its treatment for tax purposes), in our view this may be better dealt with by amendments to the Income Tax Assessment Act 1936 (ITAA 1936) rather than to the Corporations Act.

Alternatively, if Treasury considers this specific disclosure is necessary, it is our view that there needs to be a commonly understood definition of profit. Without a definition of "profit' in the Act, there may be inconsistent interpretation and application.

(c) Taxation considerations

Treasury has stated that there is no intended change in taxation treatment as a result of the proposals. We do not believe this is the necessary outcome, and the actual impact of the changes will very much depend on the interpretation and application, by the Australian Tax Office (ATO).

If there is no change in taxation outcome, we would expect that if a dividend is sourced from profits (including current year profits) it would be taxable and should continue to be frankable. However, if a "dividend" is not sourced from profits, it will remain taxable but may not be frankable. The treatment of such dividends as taxable, but not frankable, will remain a significant impediment to companies commercially being able to utilise the proposed increase in ability to pay dividends.

We therefore recommend, as a matter of principle, that the ability of a company to frank a dividend should be matched to its ability to pay a dividend. If the above recommendation is adopted in relation to the wording of section 254T, an amendment to the ITAA 1936 will be needed to align the treatment of a dividend for taxation purposes with the revised test for payment of a dividend. If this recommendation is not adopted (and no change is made to clarify the tax law), it will be incumbent on the ATO to provide significant additional guidance for taxpayers on the interaction between the proposed Corporations Act amendments and the ITAA 1936. This would need to include revisions to the Taxation Ruling TR2012/5 and the Law Administration Practice Statement 2008/10 ("Application of section 45B..to share capital reductions").

3) Determining a company's financial year (section 323D)

We agree with the proposal to clarify that where an entity has a financial year that is longer or shorter than 12 months by up to 7 days or where an entity has synchronised its financial year as part of a consolidated group, that it is not precluded from being able to access the relief offered by section 323D(2A).

4) The audit appointment requirements of certain companies limited by guarantee (section 327)

We agree with the proposal to relieve public companies that are exempt from the requirement to have their financial reports audited from the requirement to appoint an auditor.

5) Improving disclosure requirements in Remuneration Reports for disclosing entities (section 300A)

(a) Remuneration governance framework

We agree that disclosure of a company's remuneration governance framework provides useful information to investors. However the most recent revisions to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (Third Edition), released on 27 March 2014, now includes disclosure relating to the remuneration committee charter and its policies and practices regarding the remuneration of non-executive directors, executive directors and other senior executives. Because this information will now be disclosed, we do not consider that this proposed legislative change is required.

(b) Disclosure of lapsed options

We agree with the proposal to require disclosure of the number of lapsed options and the year in which they were granted, in place of the existing requirement to disclose the value of lapsed options.

(c) Relieving certain unlisted companies from the obligation to prepare a remuneration report

We agree that many of the remuneration reporting requirements in section 300A of the Act are not meaningful to investors in unlisted companies. Therefore we support the proposal to relieve unlisted companies that are disclosing entities from the requirement to prepare a remuneration report.

We also recommend that consideration is given to providing similar relief to other types of entities. For example, some listed companies have subsidiaries which are also classed as listed disclosing entities by virtue of having debt instruments listed on the Australian Stock Exchange. These listed subsidiaries would not be relieved of the requirement to prepare a remuneration report by the proposed amendment, but many of the remuneration disclosure requirements would not be meaningful because, for example, remuneration policies are often set by the parent entity by reference to the performance of the whole group. We recommend that section 300A is amended to permit such companies to refer investors to the parent entity's remuneration report.

(d) Other suggested changes to the Remuneration Report

Whilst we agree with the minor changes proposed to the Remuneration Report in this draft Bill, we note that there have been a number of issues raised in previous years in relation to the overall content of the Remuneration Report. Some of these issues and proposed changes have been raised by Treasury in previous draft bills (14 December 2012 and 17 April 2013) which are no longer included in this 2014 Bill. Our views and recommendations on these matters, as well as additional 'housekeeping' matters, have been raised with you in our previous submission responses.

We note that independent reports in recent years have also highlighted a number of recommendations for further improvement of remunerating reporting. These include the Corporations and Markets Advisory Committee (CAMAC) Executive Remuneration Report (April 2011) and the Productivity Commission report on Executive Remuneration in Australia (January 2010).

The overall usefulness of the Remuneration Report has diminished for a number of reasons, including the complexity and detail of disclosure requirements and a perceived disparity between these requirements and decision useful information for investors. This highlights the need for a more fundamental review of the existing legislation, its objectives and the level of disclosure needed to achieve those objectives. We therefore welcome the opportunity to engage with you further on this issue, share our perspectives and work towards developing an enhanced disclosure framework for remuneration reporting.

6) Improve the efficiency of the Takeovers Panel (ASIC Act)

We agree with the proposal to allow members of the Takeover Panel to perform functions and powers of the Panel while overseas.

7) Extend Remuneration Tribunal jurisdiction (ASIC Act)

We agree that the Remuneration Tribunal is better placed to determine the remuneration of the offices of the Financial Reporting Council (FRC), the Australian Accounting Standards Board and the Auditing and Assurance Standards Board than the Minister or the FRC. Therefore we support the proposal to amend the ASIC Act to transfer responsibility for determining the remuneration of these offices to the Remuneration Tribunal.