15 March 2013

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 (Remuneration Disclosures and Other Measures) Bill 2012

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 200,000 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 detailed comments on those documents are set out in attached Appendices as follows:

Appendix A – Dividend test amendments
Appendix B – Remuneration report considerations

In summary, we consider that further changes are required to be made to the draft legislation and the need for a regulatory impact statement (**RIS**) reassessed before a bill is presented to Parliament for legislative approval.

Dividends test amendments

CPA Australia and the Institute welcome the fact that the proposed dividends test amendments address some of the uncertainty in the existing law that is the consequence of the amendments to the *Corporations Act 2001* (**Corporations Act**) made by the *Corporations Amendment (Corporate Reporting Reform) Act 2010* (the **2010 amendments**).

Our main issues with the proposed amendments are threefold.

Firstly, the proposed amendments continue to link the ability to pay a dividend to the accounting standards or financial records. The continued linkage to accounting standards or financial records is not conducive to the intended replacement of the capital maintenance concept that was envisaged by the introduction of a solvency test.

Solvency, being a cash flow focused concept, it is not only affected by accounting standards. It is impacted by many other factors that should be taken into account in determining a dividend. We continue to advocate a solvency test based on the test in New Zealand so as to foster further consistency as contemplated by the Trans-Tasman agreement between Australia and New Zealand. If anything, recent experience with existing section 254T confirms to us that this is the preferred approach.

Secondly, the ED does not address the interaction of the dividends test with the Corporations Act capital maintenance provisions in Chapter 2J of that Act. Indeed, the proposed amendments have created further confusion as, on their face, they contradict the purpose of the amendments and the position adopted by Treasury in its Discussion Paper that the better view was that section 254T was intended to be an authorising provision.

In our view, the uncertainty regarding the interaction of these rules must be resolved unambiguously by legislation. A number of commentators have made suggestions as to how the Corporations Act could be amended to resolve the current tension between section 254T and the capital reduction rules. We urge Treasury to carefully consider these options prior to finalising the bill.

Thirdly, 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 express our disappointment that the opportunity was not taken to align more closely the circumstances in which corporation law dividends may be franked. We believe that such an alignment should be effected when it is affordable from a revenue perspective. That said, there are consequential taxation issues associated with the amendments made by the 2010 amendments themselves which should be considered prior to finalising any amending bill.

Further, we consider that the regulators have a role to play in ensuring that the confusion following the 2010 amendments is not repeated. Accordingly, CPA Australia and the Institute recommend that, concurrently with the introduction of the bill into Parliament:

- The Australian Securities and Investment Commission (**ASIC**) should publish guidance material dealing with the effect of the corporations law changes on the ability of companies to pay a dividend; and
- the Australian Taxation Office (**ATO**) should also issue guidance on the proposed new section 254T, akin to that provided in TR 2012/5 *Income tax; section 254T of the Corporations Act 2001 and the assessment and franking of dividends paid from 28 June 2010* (**TR 2012/5**) in relation to the 2010 amendments.

To the extent necessary such guidance should be accompanied by counsel opinion supporting the regulators' positions.

Remuneration report considerations

CPA Australia and the Institute applaud the government policy that aims to introduce simplification in the area of remuneration reporting. However, overall we consider the proposed legislative changes to disclosures will not result in an 'improved' remuneration report, as noted as being the objective in the EM.

Our main issues with the proposed changes are outlined below.

Firstly, the Governance Framework requirements replicate existing practices of many companies. Therefore, we fail to see the necessity for further legislated disclosure requirements in this area.

Secondly, we consider the categorisation of pay disclosures and the termination arrangement disclosures will not add clarity and will make remuneration reporting more complex, burdensome to preparers and potentially misleading to users.

We recommend that the categorisation of pay disclosures are streamlined and simplified, and should aim to replace the current requirements, rather than be an addition to the current requirements. Further, we consider the termination arrangement disclosures are unnecessary as they are adequately disclosed under the existing requirements of the corporations law.

Finally, we acknowledge that the claw back disclosures in relation to overpaid remuneration where the companies whose financial statements have been materially misstated will result in some increased transparency. However, we do not believe that legislation is warranted in this area. We would prefer that the requirements are dealt with as part of the ASX Corporate Governance Council's Principles which are more conducive to 'if not, why not' disclosures, than legislation.

Regulatory impact statement

CPA Australia and the Institute disagree that the proposed changes, particularly in their current form, are only 'minor and machinery in nature'. We therefore recommend that Treasury reassess the need for a RIS whether the proposed changes proceed in their current or an amended form. We consider that a comprehensive RIS should be factored into the legislative design process.

In our view, the compliance costs for companies in relation to the any section 254T amendments will be significantly reduced if those amendments are accompanied by guidance in relation to both company and taxation law along the lines suggested above.

We are prepared to assist Treasury identify matters that the RIS should consider and make recommendations on what other guidance might be suitable for inclusion in the EM and/or guidance to be published by the regulators.

Commencement provisions and transitional no prejudice rule

The proposed amendments to the dividends payment tests are intended to apply from the date of Royal Assent subject to a transitional rule for companies which declare a dividend before, but pay it after, that date.

Consistent with our submission on Treasury's Discussion Paper, *Proposed amendments to the Corporations Act*, we urge Treasury to consider providing directors with a "transitional no prejudice" rule for both corporations and income tax law in the event that they have paid dividends on the basis that existing section 254T authorised the payment of dividends out of capital. In our view this is appropriate given the intention of the 2010 amendments and the differing views which have subsequently emerged in relation to their effect.

CPA Australia and the Institute are committed to assisting where possible in the continued improvement of corporate and tax regulation in Australia. We hope that the comments provided are of assistance to Treasury. 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

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Appendix A

Dividends test amendments

CPA and the Institute welcome the proposed amendments to deal with:

- companies which declare, as opposed to determine, dividends; and
- companies which are not required to prepare a financial report in accordance with accounting standards and which, under the proposed amendments, may now determine net assets by reference to the financial records required to be kept under section 286 of the Corporations Act.

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

- the determination of assets and liabilities remains linked to accounting standards (for companies lodging financial statements) or financial records (for other companies) – refer discussion below;
- the timing of determination of the assets and liabilities is immediately before the dividend is declared or paid in the ED. However we note that this may cause an extra burden for companies to determine assets and liabilities at this date, which will usually not be at their financial year end.
- the interaction between the dividends test in section 254T and the capital maintenance provisions in Chapter 2J has not been addressed – refer discussion below;
- the ED does not address a number of other matters which are areas that should be considered for the purposes of solvency as they are dealt differently in the accounting standards to that required under law. These include:
    - o whether contingent liabilities and preferential dividend rights should be treated as liabilities for solvency purposes;
    - o whether .the calculation of surplus assets should be modified where share capital is wholly or partly an accounting liability; and
    - o whether the existing rules governing the redemption of redeemable preference shares remains appropriate.

On the basis that section 254T is made an authorising provision, the explanatory memorandum to the amending bill should specifically state that the proposed amendments do not override a company's constitution which requires that dividends be paid only out of profits.

Continued linkage to accounting standards for companies lodging financial statements

Consistent with the position adopted both in our submission on the original proposal in 2010 and on Treasury's 2011 Discussion Paper, *Proposed amendments to the Corporations Act*, the preferred approach of CPA Australia and the Institute is that Australia should adopt a solvency test similar to the New Zealand solvency test. The New Zealand solvency test has two limbs:

- the company must be able to pay its debts as they become due in the normal course of business; and
- the value of the company's assets must be greater than the value of its liabilities.

The New Zealand solvency test does not expressly require that assets and liabilities be determined in accordance with accounting standards or financial records and the inclusion of such a requirement would be inconsistent with a cash flow focused concept of capital maintenance.

Adopting an approach similar to New Zealand would be consistent with the Trans-Tasman agreement between the two countries to harmonise corporate law requirements. New Zealand has had its solvency test in place for some time without any significant practical or legal problems to our knowledge.

The key reason why a solvency test based on the New Zealand model would work well in Australia is that, by avoiding the strict link to accounting standards:

- it caters for non-lodging entities which are not otherwise required to apply accounting standards; and
- it allows the fair value of assets and liabilities, including contingent liabilities, to be taken into account.

We acknowledge that the proposed amendments achieve the first outcome and should simplify the process of paying dividends for small companies that are not required to prepare financial statements.

Proposed section 254T would also seem to allow wholly owned companies that do not lodge a financial report under the relief provided by ASIC's 98/1418 to determine net assets by reference to the financial records of the company and we recommend that the EM make this clear.

However, by continuing to require companies to value assets and liabilities by reference to accounting standards or financial records, those companies which have sufficient cash to pay dividends whilst remaining solvent may be prevented from doing so because they do not have sufficient net assets based on their statutory balance sheet or financial records. Companies likely to be adversely affected include those which have extensive intangible assets that cannot be re-valued under accounting standards and those which carry their property, plant and equipment at cost.

Should the Government choose to adopt a net asset test along the lines of that in New Zealand, then the New Zealand legislation should provide a helpful and tested precedent. Adapting the wording of section 4 of the New Zealand Companies Act 1993:

"…in determining for the purposes of this Act…whether the value of a company's assets is greater than the value of its liabilities, including contingent liabilities, the directors-
(a) *Must have regard to*-
 (i) The most recent financial statements of the company that comply with [section 295 of the Corporations Act]; and
 (ii) All other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets and the value of the company's liabilities, including its contingent liabilities.
(b) *May rely on valuations of assets or estimates of liabilities* that are reasonable in the circumstances." [*Emphasis added*]

Furthermore, we note from recent research done by the Australian Accounting Standards Board (**AASB**), the number of companies lodging special purpose financial reports (SPFRs) is significant (approximately 70% of all reports lodged). For those entities that prepare SPFRs to meet the requirements of Part 2M.3 of the Corporations Act, the wording of the application paragraphs of the recognition and measurement accounting standards makes it clear that it is not the AASB's intention to require that the obligations of those standards apply to them. In contrast, the ASIC regulatory guide RG 85: Reporting requirements for non-reporting entities requires entities preparing special purpose accounts to adopt all the recognition and measurement requirements of accounting standards. The research undertaken by the AASB indicates that this guide may not be consistently applied by companies which are non-reporting entities.

Where financial reports are required to comply with one or more of the accounting standards, the ED requires that net assets be calculated having regard to all of the accounting standards then in force. In the light of the AASB research, we recommend that Treasury consider the regulatory impact of this requirement before finalising the bill. We note that adopting the New Zealand approach to solvency would address this issue.

Interaction between section 254T and the capital reduction rules

A fundamental concern with the dividends payment test as currently drafted - and as it is proposed to be amended - is how it interacts with the capital reduction rules in Chapter 2J. As Treasury is aware, there are contesting views regarding how the current section 254T might be interpreted.

For the purpose of determining the effect of the 2010 amendments on the taxation of dividends the ATO sought a legal opinion from Messrs AH Slater QC and JO Hmelnitsky. Their Joint Opinion[1] on the impact of the corporations law amendments contained in those amendments formed the basis of, and was released at the same time as, TR 2012/5.

The view adopted in the Joint Opinion is that section 254T is not an authorising provision but imposes additional statutory constraints on what a company might otherwise do as a matter of company law.

As a matter of company law, the Joint Opinion considers that, despite the 2010 amendments, dividends may still only be paid out of profits. Unless otherwise authorised (which section 254T does not do), distributions may only be paid out of capital if they satisfy the requirements in Chapter 2J. While not totally in agreement with the views expressed in the Joint Opinion, Messrs R Austin and G Golding[2] agree that on its face section 254T does not authorise the payment of dividend. They acknowledge that the negative drafting of section 254T, which remains unchanged in the ED, is a serious issue.

We understand that a view to the effect that section 254T does allow the payment of dividends from capital has been expressed by Messrs Jackman SC and Tyson in an opinion dated 6 April 2011[3]. To the extent that this opinion informed the drafting of the proposed amendments, it is unfortunate that it was not made public.

The result of the differing views is that companies currently do not know with certainty – and will not know if the ED goes ahead in its present form – whether it is permissible for directors to declare a dividend or determine that a dividend be paid where the payment has the effect of reducing the company's share capital.

The view of CPA Australia and the Institute is that the proposed amendments must make absolutely clear that section 254T is an authorising provision for the payment of dividends.

In this regard we note that a number of commentators have made suggestions as to how the Corporations Act could be amended to resolve the current tension between section 254T and the capital reduction rules. These range from a minimalist approach to the problem within the constraints of the existing provisions[4] to "a complete reconception and redrafting of Chapters 2H, 2J and at least in part 2M"[5] to embed a pure solvency test, i.e. without limiting dividends to surplus net assets however calculated. We also note that the New Zealand provision dealing with distributions is expressed in the positive.

To avoid a repetition of the confusion which resulted following the 2010 amendments, we also consider that, simultaneously with the release of the bill introducing the proposed amendments, there should be guidance material issued by the respective regulators, namely, ASIC in respect of the Corporations Act changes and the ATO in respect of the impact of those changes for tax purposes. To the extent necessary this should be supported by legal opinions which are made publicly available, in a similar fashion to the Joint Opinion which was made publicly available by the ATO in relation to the 2010 amendments. Whether stakeholders agree or not, they should at least know how the legislature and the regulators consider the corporations law and, based on that, the taxation law applies.

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[1] The Joint Opinion, *Corporations Amendment (Corporate Reporting Reform) Act 2010, Payment and franking of dividends* dated 9 November 2011 can be found at http://law.ato.gov.au/pdf/pbr/slater_and_hmelnitsky-payment_and_franking_of_dividends.pdf

[2] *Difficulties with and proposals to reform Australia's dividend rules,* Law Council of Australia Business Law Section seminar, 20 October 2012.

[3] The Jackman SC and Tyson opinion is referred to in the Joint Opinion, page 14

[4] Refer Austin and Golding paper.

[5] Commentary on the Austin and Golding paper by AH Slater.

Income tax interactions

We acknowledge the comments in the draft EM that the proposed amendments to section 254T are not designed to change the taxation arrangements for dividends. Based on our discussion with Treasury, we understand that this is at least in part due to revenue concerns.

Within this framework we make the following observations.

Firstly, the minimalist approach to the Corporations Law amendments adopted in the ED does not necessarily guarantee minimalist tax impacts.

As Treasury is aware, there are different views in relation to the operation of both the corporations and income tax law which will survive the proposed ED amendments. For example, the ATO does not accept all of the views in the Joint Opinion in relation to the operation of the corporations or income tax law in relation to the payment and taxation of dividends. While this leads to uncertainty, it also provides an opportunity for companies to adopt reasonably arguable positions which do not accord with the ATO ruling and which could well have adverse revenue impacts. So, for example, in the non-listed environment there may be minimal downside in pursuing a strategy to pay dividends out of capital to release trapped franking credits which ultimately turn out to be a tax free return of capital.

We acknowledge that adoption of a solvency test akin to that in New Zealand would expand the circumstances in which a company may pay dividends and hence possible tax risksHowever, there are already tax risks as highlighted in the previous paragraph.

Secondly, there are tax issues which have arisen as a result of, or exacerbated by, the 2010 amendments which are not limited to the ability to frank dividends which the ATO has sought to address in TR 2012/5. Even if the Government does not wish to change the taxation of dividends, these issues should be considered as part of the current legislative design process. In this regard we highlight:

- the legislative/policy issues raised in Section 3 of the Joint Professional Bodies submission on Draft Taxation Ruling TR 2011/D8, the predecessor to TR 2012/5[6]. The ATO's response to a number of those issues, as set out in its Ruling Compendium[7], confirms that these are issues for Treasury.

  In addition, in Section 2 of that submission, the Joint Professional Bodies highlight a number of potential implications of the 2010 amendments, the draft ruling and Joint Opinion for other parts of the income tax law. The ATO's response to a number of those issues, also set out in its Ruling Compendium[8], suggests that the legislative design process would benefit from the ATO doing some high level "issue spotting" and, where necessary, providing recommendations to Treasury on potential legislative issues.

- the number of provisions in the *Income Tax Assessment Act* (**ITAA**) *1936* and *1997* which make reference to the term "profits" and which may require consideration and possible amendment as a consequence of any move away from a profits based test for the payment of dividends[9].

- the fact that, on the face of it, the 2010 amendments and, in particular, the insertion of section 44(1A) to the ITAA 1936 has resulted in capital distributions to partners of a corporate limited partnership being taxed as dividends as they are deemed to be paid out of profits. This issue is elaborated upon in the paper referred to in footnote 9 and has been referred to the ATO.

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[6] The Joint Professional Bodies submission dated 5 March 2012 is available on the Institute's website The Joint Professional Bodies comprised the Institute, CPA Australia, The Tax Institute, The Institute of Public Accountants and Taxpayers Australia
[7] Ruling Compendium TR 2012/5EC is available on the ATO website - see in particular ATO's response to issue 7, 60-64 and 66-67
[8] See for example issues 55 to 59 of Ruling Compendium.
[9] Wayne Plummer and Michelle Hogg, *Can we frank that dividend?* The Tax Institute's Corporate Tax Masterclass, 30 October 2012

Thirdly, companies and other stakeholders are entitled to expect that the taxation implications of the proposed amendments to the corporations law are considered and communicated.

In this regard we note that any corporations law changes, however minimal, will mean that the current ATO's ruling dealing with the assessment and franking of dividends, TR 2012/5, will not be binding guidance on the new law. Even with the benefit of TR 2012/5 and the accompanying Joint Opinion, the interaction between corporations law and income tax remains complex and there are different views in relation to the operation of the existing law. These include whether:

- distributions may be made out of current year trading/realised capital profit when there are accumulated losses;
- distributions may be made out of past profits when there are current year losses;
- distributions are out of unrealised capital profit reserves of a permanent nature as opposed to unrealised capital profits reserves not of a permanent nature;
- distributions out of other comprehensive income are distributions out of profits; and
- distributions fall within the dividend exclusion of being debited to a share capital account.

Overlaying even minimal legislative changes in this environment warrants updated guidance to limit the uncertainty and confusion which arose following the 2010 amendments and which still exists notwithstanding TR 2012/5.

As submitted above, in our view, simultaneously with the release of the amending bill there should be guidance material issued by the respective regulators in respect of the Corporations Act changes and the impact of those changes on the taxation of dividends. Guidance from the ATO is particularly important as, in the absence of any tax changes in the bill introducing the proposed amendments, there is limited scope to provide guidance in the explanatory memorandum.

Commencement date and transitional rule

The proposed amendments are intended to apply from the date of Royal Assent subject to a transitional rule for companies which declare a dividend before, but pay it after, that date. Consistent with our submission on Treasury's Discussion Paper, *Proposed amendments to the Corporations Act*, we urge Treasury to consider providing directors with a "transitional no prejudice" rule for both corporations and tax law in the event that they have paid dividends on the basis that existing section 254T authorised the payment of dividends out of capital. In our view this is appropriate given the intention of the 2010 amendments and the differing views which have subsequently emerged in relation to their effect.

Regulatory impact statement

We do not consider the proposed amendments to the dividends payment tests, particularly as currently drafted, to be "minor and machinery in nature". This is confirmed by recent experience with existing section 254T.

However, in our view, the compliance costs for companies in relation to any amendments will be significantly reduced if those amendments are accompanied

Appendix B

Remuneration report considerations

CPA Australia and the Institute applaud the government for aiming to introduce simplification in the area of remuneration reporting. However, overall we consider the proposed legislative changes to disclosures will not result in an 'improved' remuneration report, as noted as being the objective in the EM.

We detail our specific concerns below.

Remuneration governance framework

The Remuneration Governance Framework requirements replicate existing practices of many companies. Therefore, we fail to see the necessity for further legislated disclosure requirements in this area.

The annual report already covers some of this information described in this Remuneration Governance Framework. This includes details of the members of a company's remuneration committee, changes in membership and the qualifications and experience of members. Some of this information is already contained in the ASX Corporate Governance Principles and other parts exist in the current corporations law.

Therefore it is unclear as to what the purpose or the intention may be to include this information specifically in the remuneration report. The EM states that the intention is to 'improve disclosure requirements'. However we are unsure as to the exact nature of this improvement.

The EM mentions the possibility of cross referencing information. While cross referencing is supported, to ensure that the same information does not need to be disclosed multiple times, care must be taken to ensure whether it is appropriate that this information is audited and therefore included part of the remuneration report, or whether it is more appropriate for it to remain unaudited.

Options

We support the proposed disclosure simplifications regarding options. We agree that this will simplify the remuneration report without adversely affecting shareholders.

Benefits of termination

We consider the termination arrangement disclosures are unnecessary as they are adequately disclosed under the existing requirements of the Corporations Law. Further, the requirements as drafted are confusing and misleading to both preparers and users.

The existing requirements in the Corporations Act are included in section 300A(1)(e)(vvii) and also Item 9 of Reg 2M.3.03 of the *Corporations Regulations 2001* (**Corporations Regulations**). Further, there are limits placed on a company's ability to make payments to members of the key management personnel (KMP) in connection with their termination under sections 200A-J of the Corporations Act. We consider these existing requirements sufficient for the purposes of termination benefit disclosures. However, if concerns remain that the existing provisions did not cover an appropriate break down of that figures into categories of payment, this could be amended by amending the requirement under Item 9 of Reg 2M.3.03 of the Corporations Regulations.

Some additional points are noted on the current drafting of section 300A(1)(ea), which should be taken into consideration if the section is to remain. These issues are around the tightening up of the language used, for clarity purposes, as well as to enhance the interaction of the existing section 300A(1)(e)(vii) and the proposed new section 300A(1)(ea). They include:

- The wording 'to be given' must be amended, as this seems to imply that forward looking information is being sought. We do not believe this is the government's intention.
- The wording in the existing section refers to "payments" to be made on "termination" and which are provided for in contracts with 'employees'. In contrast, the proposed section requires disclosure of "benefits" (which is defined to include payments) to be provided as a consequence of "retirement" (defined sufficiently broadly to capture termination) from any office or employment. We assume, but cannot be sure, that the existing section disclosures are not intended to include benefits, and do not capture directors or others who are not employees. Therefore, we anticipate the new section is designed to capture this, however the comments in the EM suggest that the new paragraph is intended to capture non-contractual benefits and payments. Therefore, the terminology used between the existing section and the new section needs to be enhanced so these sections work together better to provide the preparers some clarity as to the requirements.

Remuneration outcomes

We consider the categorisation of pay disclosures will not add clarity and will make remuneration reporting more complex, burdensome to preparers and potentially misleading to users.

The current form of the proposals to require the disclosure of past, present and future pay will only serve to increase the complexity of the remuneration report, rather than assist in enhancing shareholders' understanding of remuneration outcomes of members of the KMP. Our view is based on the following reasons:

- the proposed disclosures are in addition to the current disclosures already required under Items 6-11 of reg 2M.3.03 of the Corporations Regulations, with no requirement to reconcile the information between the current and the new disclosures. This is likely to confuse the user community with additional disclosures bearing little resemblance to the existing disclosures. Further, an additional disclosure requirement will increase the regulatory burden on the preparer community.
- the lack of definition or guidance for the three categories of 'past', 'present' and 'future' to be disclosed may lead to inconsistent practices being applied.
- over a number of consecutive reporting periods the details disclosed as proposed would in effect be double counted (as the present becomes the past and the future becomes the present), thus leading to even further confusion by the user community. This would be especially an issue if users add the three values together, as these are independent values and are not capable of summation and if inadvertently summed the total cannot represent a 'total' of all remuneration earned during the period.
- it is unclear as to how the requirements in the different categories will be measured – is it cost to the company or value to employee?

We recommend that the categorisation of pay disclosures are streamlined and simplified, as we do not see users understanding of the remuneration report increasing through more disclosures. There is no need to keep the current requirements and the new requirements, and therefore recommend that the current requirements contained in Items 6-11 of reg 2M.3.03 of the Corporations Regulations be repealed. The final categorizations of pay disclosures to be used should be clearly defined in legislation, to ensure consistency and simplification of understanding. The final disclosures included in legislation should be those that are most relevant and useful to the user community, without the need for lengthy explanations and duplication.

Clawback of remuneration

We acknowledge that the claw back disclosures in relation to overpaid remuneration where the companies whose financial statements have been materially misstated will result in some increased

transparency. However, we do not believe that legislation is warranted in this area. We would prefer that the requirements are dealt with as part of the the ASX Corporate Governance Council's Principles which are more conducive to 'if not, why not' disclosures, than legislation.

We note that the members of the ASX Corporate Governance Council are currently revising these principles, so it would be an opportune time for them to take such considerations into account. We would also refer to the public comments received in response to the Discussion Paper *The clawback of executive remuneration where financial statements are materially misstated* in 2010. The majority of comments received in response to this Discussion Paper were opposed to adopting a prescriptive approach in relation to the clawing-back of remuneration.

Some practical tax considerations are noted below, that should be considered when finalising a policy position in this area.

In order to facilitate a reduction, repayment or other alteration to the remuneration of members of the KMP in the event that there is a material misstatement in the financial statements of listed disclosing companies in the prior three years it is likely that member service contracts, employee share plans and the like will need to be renegotiated or amended.

Seeking to clawback remuneration already paid, even if contemplated in a member's service contract, is likely to be problematic. To a large extent, therefore, we would expect that companies will respond by seeking to defer entitlement to performance related remuneration, such as bonus and equity based remuneration, including after a member ceases employment with the company.

However, there is an issue under the employee share scheme rules generally in that termination of employment triggers a taxing point for shares or rights notwithstanding that they remain subject to risk of forfeiture. Practically speaking, risks of forfeiture and any restrictions on the disposal of shares or rights need to be lifted on termination of employment to enable employees to dispose of them, or sufficient of them, to fund their tax liability.

The view of the CPA Australia and the Institute has always been that the cessation of employment should not be a taxing point under the employee share scheme rules to enable companies to better align performance remuneration with long term goals and shareholders' interests[10]. This is consistent with the view expressed by the Productivity Commission[11]. In the context of the proposed amendments, it would also facilitate companies ensure that former employees and directors do not benefit inappropriately from material misstatements in the financial statements which arose on their watch.

We therefore believe that the Government should consider removing cessation of employment as a deferred taxing point as part of these amendments.

Relieving certain unlisted entities from the obligation to prepare a remuneration report

We are supportive of the removal of the requirement for certain unlisted companies to prepare a remuneration report.

Regulatory impact statement

We also do not consider the changes to be 'minor and machinery in nature' as they will increase the compliance costs of listed disclosing companies. This includes, in the case of the proposed clawback rules, the likely need to renegotiate employment contracts to allow overpaid remuneration to be clawed back.

We therefore consider that a comprehensive RIS be factored into the legislative design process.

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[10] See for example the Institute's 17 July 2009 submission to the Senate Economics References Committee's inquiry into employee share schemes.

[11] *Executive Remuneration in Australia* (released 4 January 2010)