

Director
Corporate Tax Policy Unit
Treasury
Langton Cres
Parkes ACT 2600

By email: frankeddistribconsult@treasury.gov.au

Dear Director,

I wish to submit a response to the consultation on the proposed legislation relating to Franked Distributions and Capital Raising.

I object to the proposed legislation changes.

I believe the draft legislation is inequitable to Australian companies and shareholders and it could inadvertently impact situations of legitimate company operations.

The draft legislation fails to recognise the fundamental principle underlying the franking regime and the reason for its creation, the avoidance of double taxation on company earnings.

The Franked Distribution and Capital Raising draft legislation, if widely applied, will lead to the demise of the franking system. It will stop Australian companies who issue new shares under a Dividend Reinvestment Plan (DRP) from paying franked dividends and significantly increase the cost of capital for all franked dividend paying Australian companies. It will also risk the stability and integrity of the Australian banking system by inhibiting effective capital raising during challenging economic periods such as the start of the coronavirus pandemic.

It would seem that the proposed legislation will be retrospective to when the previous Government first proposed the changes. If that is indeed the Labor Party's intention, then amended assessments for millions of honest Australia tax payers (Individuals, companies, SMSF's etc) going back to December 2016 will be issued.

The financial impact of such amended assessments will be incalculable and the requirement for entities such as superannuation funds (both public and SMSF's) to amend their accounts for the retrospective debt created by the proposed legislation will be onerous and costly to say the least.

It is not the fault of the taxpayers in receipt of fully franked dividends who would be penalised due to decisions by companies in which they have invested to raise capital and then pay dividends.

It would be impossible to police the reasons why a company raises additional capital and to try and say "you did that so you could pay a dividend" would mean the courts would be forever clogged up by companies appealing any decisions by the ATO to deny the franking credits.

Remember that the franking credit regime was introduced by the Keating Labor Government in 1987 in order to stop the double taxation of income: once in the hands of the companies being taxed on their income and then again in the hands of shareholders receiving their share of the already taxed dividend income.

Retrospective legislation, in any form, is bad government.

To remove the benefits of stopping double taxation of income is also bad government.

By introducing the proposed legislation, the government is proposing to take away the right of companies to manage their capital requirements as the directors see fit.

Perhaps if the government was subject to the same rules – stopping the government borrowing money to fund its capital requirements – then we would all be playing to the same rules.

This is bad legislation with the potential to completely destroy the Australian economy.

It will also impact the savings plans of millions of Australian retirees – tell me honestly that Treasury and the current government do not think that that will happen.

Please contact me on alan@brownca.com.au if you have any questions on the above submission.

Yours sincerely,

Alan Brown CA

1. There would be unintended consequences based on the current drafting of the proposed legislation

As drafted, the proposed legislation does not sufficiently distinguish between acceptable activities and the tax avoidance situations it intends to address. The proposed legislation would appear to inadvertently impact situations of legitimate company operations and could accordingly delay or discourage the normal processes of capital raising, investment and economic growth in Australia and interfere with the operation and the efficiency of the Australian capital markets and the structural integrity of our banking system.

For example, irrespective of the various situations of legitimate capital management, capital raising and franked dividend payments by Australian companies, the draft legislation is broad enough that it could also capture the well-established act of implementing Dividend Reinvestment Plans (DRPs) and DRP underwritten capital raisings in the circumstances where, in Treasury's broad view, the established practice test is not met.

The current draft of the legislation will have severe impacts to our authorised deposit-taking institutions (Australian banks) and would be contrary to the Australian Prudential Regulation Authority's (APRA) guidance provided in the most recent time of economic stress during the COVID-19 pandemic.

In April 2020, APRA provided guidance to all authorised deposit-taking institutions, primarily impacting Australia's big four banks, on capital management. This guidance included an expectation that Boards would seriously consider deferring decisions on dividends given the economic uncertainty due to the coronavirus pandemic. It would also offset any dividends to the extent possible through other capital management initiatives, including DRPs and other capital raising initiatives to partially offset the diminution in capital from the payment of franked dividends to shareholders. As Australia moved beyond the initial phase of response, APRA updated the guidance to assist longer-term capital management enabling banks to fulfil their role in supporting economic recovery. As part of this, APRA recommended they actively used DRPs "and/or other capital management initiatives" to offset the reduction in their capital base and balance sheets from making franked dividend payments to their shareholders. The proposed drafting of the legislation changes will risk the stability of the Australian banking system by inhibiting effective capital management during challenging economic times.

2. Managing cash flows between capital raising and distributions can represent the normal and legitimate flow of commercial capital management

The drafted legislation removes the ability of operating businesses to legitimately manage and invest their cash flows productively. Once a company has generated a profit and reinvested it, it can only create liquidity to pay a dividend by raising debt, selling some of its assets (which might not be viable) or by raising capital. By removing the ability to raise capital to reward shareholders, companies will need to increase their debt levels or they will be put in a position where they will be unable to grow and further develop their businesses. While there are instances of companies manipulating the tax system, companies that have legitimately earned profits and paid tax should be entitled to choose how they invest or distribute those profits to their shareholders.

3. The proposed legislation would burden thousands of Australian shareholders who have planned or are planning their retirement, placing stress on individuals and on the Australian pension system

The dividend imputation system has not fundamentally changed for over 20 years and implementing change now, and retrospectively, on people who are already retired and, in many cases, cannot return to work, will burden individuals, their families and in turn the economy, all of which will face economic uncertainty.

4. Retrospectively

I note the retrospective application to 19 December 2016 would unfairly prejudice franked dividends paid out to shareholders of Australian companies and leave them with unexpected tax bills for dividends they have since received, to be paid at a time of economic uncertainty. This is particularly concerning for those who rely on fully franked dividends as income. The draft legislation appears to inadvertently target situations of legitimate company operation making it difficult to form a conclusive judgement as to the legitimacy of historical and future payments of fully franked dividends by Australian companies. Tax laws should not be allowed to change retrospectively when Australians have budgeted for and paid their lawful tax assessment based on existing tax law in place.

Conclusion

While I appreciate Treasury is trying to deal with situations involving tax avoidance and franked dividend distributions, the proposed legislation, as drafted, will fundamentally change the nature of how Australian companies manage their capital, increase their cost of capital and negatively impact Australian shareholders.