

**Director  
Corporate Tax Policy Unit  
Treasury  
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By email: [frankeddistconsult@treasury.gov.au](mailto:frankeddistconsult@treasury.gov.au)

Dear Director,

Thank you for the opportunity to submit a response to the consultation on the proposed legislation relating to **Franked Distributions and Capital Raising**.

We object to the proposed legislation changes.

We 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.

The franking regime has benefited the Australian economy since its inception by ensuring Australian corporates are adequately funded by equity rather than creating an incentive to over leverage with debt (serviced by deductible interest) as has been the case with major developed economies such as the US, UK and Europe (all with classical dividend tax regimes) which unlike Australia suffered a recession during 2008 as corporate and banking sector indebtedness led to the collapse of many listed companies. Any move to overly complicate, disadvantage and place artificial restrictions on the franking ability of Australian tax paying corporates would undermine this feature of the franking regime. We note that New Zealand which also has a full imputation franking regime has not seen the need to implement any measures of the type proposed

Yours sincerely,

Gilbert Chan

## **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**

We 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.

### **5. Undermines the benefit of full dividend imputation regime incentivising an adequately capitalised corporate and banking sectors which created resilience in the Australian economy**

During the 2008 Global Financial Crisis, jurisdictions with classical dividend tax regimes (eg US, UK, Europe) suffered more corporate collapses than jurisdictions with full dividend imputation (eg Australia and New Zealand) due to the full dividend imputation regimes creating an incentive for their resident corporates to be adequately capitalised with equity capital rather than excessive debt with deductible interest costs. Any move to overly complicate, disadvantage and place artificial restrictions on the franking ability of Australian tax paying corporates would undermine this feature of the franking regime. We note that New Zealand which also has a full imputation franking regime has not seen the need to implement any measures of the type proposed. We do not want to risk Australian corporates becoming thinly capitalised because these measures make the franking regime unusable for corporates that raise capital

### **Conclusion**

While we 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.