The Tax Institute

31 March 2023

Alan Raine
Committee Secretary
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By electronic upload

Dear Mr Raine,

Treasury Laws Amendment (2023 Measures No. 1) Bill 2023

The Tax Institute welcomes the opportunity to make a submission to the Senate Standing Committee on Economics (**Committee**) in respect of its inquiry and report on the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023 (**Bill**) and accompanying explanatory memorandum (**EM**).

In the development of this submission, we have closely consulted with our National Large Business and International Technical Committee and National Small and Medium Enterprises Technical Committee to prepare a considered response that represents the views of the broader membership of The Tax Institute.

The Bill contains several key changes that impact taxpayers and tax practitioners. These include:

- Schedule 3 – Government response to the review of the Tax Practitioners Board;
- Schedule 4 – Off-market share buy-backs;
- Schedule 5 – Franked distributions funded by capital raisings.

The Tax Institute, in conjunction with several other professional bodies and associations (together the **Joint Bodies**), is a co-signatory for a submission to the Committee with respect to Schedule 3 of the Bill. Our views on Schedule 3 are reflected in the Joint Bodies' submission and are not reiterated in this submission.

Schedule 4 of the Bill contains a measure that is intended to align the capital raising activities of public companies. However, as currently drafted, the provisions result in different capital gains tax (**CGT**) treatment between off-market share buy-backs and selective share reductions.

The Tax Institute is of the view that Schedule 5 of the Bill requires further explanation and clarity regarding the scope and purpose of the proposed measure. We consider that the scope of Schedule 5 goes beyond the original policy intent contained in the Mid-Year Economic and Fiscal Outlook 2016-17 (**MYEFO announcement**). Our members have also raised concerns about the requirements in the proposed measure that will result in the arrangement becoming an unfrankable distribution. In particular:

- the established practice requirement is likely to unfairly target private groups and companies with irregular distribution patterns;
- the purpose test has a lower threshold than other anti-avoidance provisions, resulting in a larger number of arrangements being captured than originally intended; and
- the disproportionate effect of the measure making an entire distribution unfrankable, even if only a small percentage is sourced from a capital raising that is within scope.

Our detailed response is contained in **Appendix A**.

We would be please to work with the Treasury to ensure that the Bill best achieves its policy intent without resulting in inequitable outcomes for taxpayers.

The Tax Institute is committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

If you would like to discuss any of the above, please contact our Senior Tax Counsel, Julie Abdalla, on (02) 8223 0058.

Yours faithfully,

Scott Treatt

General Manager,
Tax Policy and Advocacy

Jerome Tse

Council Member

APPENDIX A

We have set out below our detailed comments and observations for your consideration.

Schedule 4 – Off-market share buy-backs

Paragraph 4.25 of the EM states that the extension of the new rules is to ensure alignment across the capital management activities of public companies. However, the proposed rules result in different treatments for off-market share buy-backs and selective share cancellations from a CGT perspective.

For off-market share buy-backs, new section 159GZZZPA of the *Income Tax Assessment Act 1936* (**ITAA 1936**) deems no part of the purchase price in respect of the buy-back to be a dividend. The deeming allows the amount received by the shareholder to be treated on capital account, potentially allowing access to a CGT discount if the relevant conditions are met. However, for selective share cancellations, new paragraph 202-45(k) of the *Income Tax Assessment Act 1997* (**ITAA 1997**) results in the distribution being unfrankable. This does not allow the amount received by the shareholders to be treated on capital account.

We recommend that Government should give further consideration to aligning the CGT implications between off-market share buy-backs and selective share cancellations. This can be achieved by deeming the entirety of the proceeds received in respect of a selective share cancellation by a listed public company to not be a dividend.

Schedule 5 – Franked distribution funded by capital raisings

Scope of measure

The MYEFO announcement for the proposed measure in Schedule 5 of the Bill was in response to concerns raised in ATO Taxpayer Alert TA 2015/2 Franked distributions funded by raising capital to release franking credits to shareholders (**TA 2015/2**). Broadly, TA 2015/2 concerned arrangements where companies undertook capital raising predominantly for the purpose of releasing accumulated franking credits to shareholders. These arrangements were contrived in nature and had little economic purpose other than to facilitate the release of franking credits.

In the MYEFO announcement, the previous Government stated its intention to introduce a measure specifically targeting special dividends issued to shareholders and accompanied by capital raisings. Examples of the types of capital raising activities contemplated in the MYEFO announcement included underwritten dividend reinvestment plans and placements/underwritten rights issues.

However, the scope of the provisions contained in Schedule 5 is broader than the original policy intent, potentially impacting commercial arrangements such as employee share schemes (**ESS**), dividend re-investment plans (**DRPs**), and unfairly penalising companies with an infrequent distribution pattern. Noting that the measure was estimated to raise only approximately $10 million over the forward estimated period,[1] there is a significant widespread concern that for what is a relatively small amount of expected revenue, the measure will have a disproportionate economic impact and increase in compliance costs for businesses.

We recommend that the Committee should request that Government reconsider the scope of the proposed measure and ensure it only targets the category of transactions that are contrived and results in inappropriate access to franking credits.

Objective of measure

TA 2015/2 notes that the arrangements of concern were likely to be subject to section 177EA of the ITAA 1936, or other existing provisions such as the anti-streaming rules in Division 204 of the ITAA 1997. While we acknowledge that these provisions may not always capture the types of transactions contemplated, we consider that it would be helpful to articulate the perceived gap.

In practice, this measure may require impacted taxpayers to incur significant compliance costs to record and demonstrate the reasons for simple or commercial activities. We consider that the scope of this measure, as well as the associated compliance burden and economic costs imposed by this measure exceed the perceived risk which it seeks to address.

We recommend that the Committee should examine the need for this measure noting the existing safeguards in the ITAA 1936 and ITAA 1997. Further, a more detailed description of the underlying mischief or perceived gap in the current legislation will better allow taxpayers and tax practitioners to understand the rationale, and apply the proposed measure to their circumstances.

Established practice

Impact on small and medium private groups

Proposed paragraph 207-159(1)(a) of Schedule 5 requires an examination of whether the relevant distribution is made as part of an established pattern of distributions. The test will be satisfied where the entity's distribution is 'outside the normal cycle' for the entity, or where there is no established practice of distributions.

We consider that this requirement is likely to be very easily satisfied by private groups that do not have a normal practice of paying regular distributions. For many private groups, the payment of distributions is often dependent on current trading performance, business cashflow and owners' personal cash requirements. In practice commercial considerations are likely to impact these factors, as well as the timing and amount of distributions made.

[1] Mid-Year Economic and Fiscal Outlook 2016-17, page 112.

Feedback from our members indicates that it is common practice for private companies to pay out a substantial portion of retained earnings as dividends prior to an equity event in order to:

- reflect the existing shareholders expectation/entitlement to the earnings accumulated to the date of entry of a new shareholder; or
- reduce the entry price for new shareholders/ESS participants, to make the investment more affordable for the new entrant.

The above practices are likely to satisfy the established practice requirement of the proposed measure, even though the purpose of the distribution in such cases is to facilitate a change in ownership rather than to manipulate the availability of franking credits. As currently drafted, this requirement is likely to significantly and disproportionately impact private groups by creating additional uncertainty around private company investment transactions.

Disregarding previous distributions from an established practice

Subsection 207-159(3) of Schedule 5 provides that previous distributions funded by equity are to be disregarded for the purposes of paragraph 207-159(1)(a). Paragraphs 5.19 and 5.20 of the EM explain that this is to ensure that taxpayers are prevented from benefitting from any historical 'mischief' the amendments seek to prevent. We consider that the disregarded historical distributions could reasonably be part of a pattern of distributions. Categorically ignoring these transactions is likely to further broaden the scope of the measure and result in a greater number of distributions being inappropriately captured by the amendments.

For example, DRPs offered prior to the commencement of the measure would not be within scope. However, DRPs offered from the commencement of the measure could be caught by the measure, especially if previous DRPs are disregarded from forming part of the established practice.

Purpose test

We consider that the operation of subparagraph 207-159(1)(c)(ii) of Schedule 5 and understanding by taxpayers and advisers could be improved by the addition of further clarification in the EM. Paragraph 5.8 of the EM refers to the manipulation of the imputation system to obtain inappropriate access to franking credits and preventing the use of artificial arrangements under which capital is raised. Further, paragraph 5.33 of the EM states that the purpose test could be satisfied when the intention to issue capital to fund a distribution is 'more than incidental to some other purpose'.

A more than incidental purpose, does not necessarily equate to an egregious arrangement. We consider that this threshold is too low, especially where there could be multiple purposes behind an arrangement and circumstances where the issuing of equity to fund distributions could be a relatively minor consideration. We recommend that the threshold should be raised to require the objects be the sole or dominant purpose of the arrangement. This should be clearly reflected in the legislative provision as well as in the EM. This would be consistent with the purpose threshold for section 177D of the ITAA 1936, and ensure that the proposed measure only targets the arrangements intended in the MYEFO announcement.

Paragraph 5.33 of the EM also provides examples of advisers and related parties of the entity, as being other parties, whose purpose could be taken into account. Where the conditions are satisfied, the entity and its shareholders will be subject to franking credit denial. If the purpose test is satisfied by an external party, there is a possibility that the promoter penalty regime in Division 290 of Schedule 1 to the *Taxation Administration Act 1953* will apply. In these circumstances the proposed measure will not require an examination of the intention of external parties to be effective. We consider that the explanatory materials should provide further guidance regarding the interaction between the proposed measure and the promoter penalties regime.

Entire distribution unfrankable if the test is satisfied in relation to part of a distribution

Under proposed paragraph 202-45(ea) the entirety of a distribution will be unfrankable where the conditions in proposed subsection 207-159(1) are satisfied in relation to part or all of the capital raised. This would mean that where even an immaterial proportion (e.g. 5 percent) of a distribution is deemed to be funded by an equity issue, 100 percent of the franking credits attached to the distribution would be denied. We consider this to be a disproportionate and punitive outcome.

Corporate groups may contain different classes of shares which could result in distributions being funded by differently. It is unclear whether the meaning of ‘entire distribution’ would be confined to a particular class of shareholders or the entire distribution to all shareholders, where part of the distribution is deemed to be funded by capital raising.

In our view, the unfrankable amount of a distribution should be limited to the portion of the distribution deemed to have been funded by an equity issue for the purpose of obtaining the benefit of the franking credits. Where a taxpayer has implemented an arrangement to pay part of a distribution from equity funding, the explanatory materials should provide a methodology to easily calculate the unfrankable portion of the distribution. We consider that apportioning the franking credit denial to the ‘tainted’ distribution will result in a fairer and more equitable outcome.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.