Director
Corporate Tax Policy Unit Treasury
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By email: frankeddistconsult@treasury.gov.au

Dear Director,
Thank you for the opportunity to respond to the consultation on the proposed legislation relating to Franked Distributions and Capital Raising.

Overview
The draft legislation fails to recognise the fundamental principle underlying the franking regime, ie, the avoidance of double taxation of company earnings.
The draft legislation, if widely applied, will very likely end the franking system by stopping Australian companies, who issue new shares under a Dividend Reinvestment Plan (DRP) from paying franked dividends. As a consequence the proposal will significantly increase the cost of capital for all franked dividend paying Australian companies.

It also risks the stability and integrity of the Australian banking system by inhibiting effective capital raising during challenging economic periods.

In addition it places a significant financial burden on individual taxpayers who use franking credits to provide cash for living and who would be forced onto the government pension.

I object to the proposed legislation changes as outlined below.

1. Legitimate commercial capital management
The draft legislation implies that capital raising is an "artificial arrangement" used to fund the payment of franked distributions to shareholders, and does not distinguish between acceptable business activities and the loophole it is trying to close. The draft legislation removes the ability of businesses to legitimately manage and invest their cash flows productively and appears to inadvertently impact situations of legitimate company operations. It could delay or discourage the normal processes of capital raising and investment for company growth.

The draft legislation is sufficiently broad to capture the well-established practice of implementing DRPs that are underwritten by capital raising, where, in Treasury's view, the established practice test is not met.

Managing cash flows between capital raising and distributions represents normal and legitimate commercial capital management practice. Once a company has generated a profit and reinvested cash in the business, it can only create the needed liquidity to pay a dividend by raising debt, selling assets (which might not be viable) or by raising capital. By removing the ability to raise capital at this time companies will be forced to increase their debt levels, sell assets or not invest cash in the business. Such actions will impede growth and business development initiatives.

While there are instances of company tax fraud, most companies are regulatory compliant and must be entitled to choose how they invest or distribute profits.

2 Inhibits regulatory responses
The current draft legislation will have severe specific impacts on authorised deposit-taking institutions (ADIs) and is at odds with APRA's guidance provided in April 2020. This guidance included an expectation, given the economic uncertainty at the time, that ADI Boards would seriously consider deferring decisions on dividends and/or to the extent possible, offset any dividends to be paid through other capital management initiatives. APRA has since updated the guidance to assist longer-term capital management by enabling ADIs to fulfil their role in supporting economic recovery. As part of the new guidance, APRA recommended ADIs actively use 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 legislation risks the stability of the Australian banking system by inhibiting APRA's ability to make regulatory capital management initiatives during challenging economic times.

3. Individual Shareholder burden
Changes to the dividend imputation system were rejected by voters in recent Federal elections and to introduce changes by stealth will burden thousands of Australian individual shareholders who have planned or are planning their retirement. People who are already retired and, and in many cases, cannot return to work, will face significant financial burdens, without new reliance on Government pensions.

In addition, the retrospective application to 19 December 2016 unfairly prejudices shareholders of Australian companies who have received franked dividends and paid their lawful tax assessment based on tax law at that time. They would have to fund unexpected tax bills for dividends they had received, and are now required to pay. This additional individual taxpayer funding burden would very likely place further stress on the government pension system.

4. Concluding remarks
The proposed legislation, as drafted, will fundamentally change the nature of how Australian companies manage their capital. It will increase their cost of capital and inhibit APRA's ability to stabilise the financial system during times of severe stress. It also significantly burdens Australian shareholders and will place unneeded pressure on the government pension system.

Yours sincerely,
Harvey Crapp