Director
Corporate Tax Policy Unit
Treasury
Langton Cres
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Dear Director

What follows is a submission on the Exposure Draft Legislation and the Exposure Draft Explanatory Materials relating to the proposal, announced and released on 14 September last, to render unfrankable certain distributions that are funded by capital raisings.

The announcement said the Government was seeking stakeholders' views and I doubt that I qualify as such.I am not a shareholder in any company other than very small holdings in a couple of listed companies as trustee for my grandchildren ;but I have always had a keen interest in this area of the law as a practitioner and former Federal Court judge. I trust that qualifies me as a stakeholder to have my views considered, if not agreed with.

I should also add at the outset that I was, and still am, strongly in favour of the Government's now abandoned policy to return our imputation system to a true credit system as it was originally enacted back in 1987, and remove the tax offset provisions in Div 207 of Pt 3-6 of the ITAA 97. Unfortunately, politics has got in the way of that policy, but it has been the catalyst for this submission because I see this proposed measure as a disguised back door way of partially achieving the same result.Invariably, such backdoor remedies turn out to be unsatisfactory solutions.

My concerns about the draft legislation and the draft explanatory materials can be summarised under three heads:

1. Contrary to what is said at 1.16 of the draft materials, the proposed amendment is not an integrity measure; it has nothing to do with shoring up the integrity of our imputation system ;the integrity of our imputation system as it stands in the Act today is not threatened or put at risk by entities raising capital to fund, or replace funds used to make, franked distributions. What this amendment is all about is to put a brake on companies making special franked distributions ,by way of the buyback of shares or otherwise ,which are outside the normal pattern of those companies regular distributions, in order to curb the loss of revenue to the Government caused by large refundable tax offsets that have to be made to zero and low tax shareholder taxpayers.If that is correct, it should be stated not hidden behind motherhood statements about integrity.

2. The retrospective operation of the proposed amendment to 19 December,2016 is outrageous. Even if it was an integrity measure, such an operation cannot be justified by reference to the Coalition Government's announcement, which preceded by over two years its re-election in 2019. But if I am right in saying the proposed amendment has nothing to with integrity and everything to with partially plugging a hole in revenues caused by refundable tax offsets to low or zero tax shareholders, then shareholder taxpayers generally (not just the low or zero tax shareholders who get a refund)should not be put to the disruption and anguish that retrospectivity will potentially cause.

3. The text and form of the proposed legislation, in particular proposed s 207-159. The text and form of the proposed s207-159 is written as an anti- avoidance provision; a retrospective anti- avoidance provision. A decision on which side of the line a case falls, as is the case with all anti- avoidance provisions, is fact rich;

cases involving facts which point to direct funding will always be easy to identify and call. It is cases on the fringe , cases at the margin, involving a question as to whether a capital raising, particularly one undertaken some time after the making of the special franked distribution, indirectly funds the anterior distribution. Of course, if the object of the proposed amendment is to plug a hole in Government revenues as I have suggested, then such uncertainty in the text and form of the legislation is probably deliberate.

I deal with each of these concerns in more detail below:

1. Integrity

At 1.16 of the draft materials it states:

" These amendments are an integrity measure. They prevent entities from MANIPULATING the imputation system to obtain INAPPROPRIATE access to franking credits. They will specifically prevent the use of ARTIFICIAL ARRANGEMENTS under which capital is raised to fund the payment of franked distributions to shareholders and enable the distribution of franking credits."

In the absence of you explaining how the raising of capital by a company to fund or assist in the funding of a distribution which is franked with franking credits which the company has MANIPULATES our imputation system, I cannot accept this statement. Nor ,in the absence of you explaining why, can I accept that it gives the company INAPPROPRIATE access to its franking credits when the only reason it cannot access them is , absent the capital raising, a lack of funds.Nor can I accept, in the absence of explanation, why the raising of capital is an ARTIFICIAL ARRANGEMENT.

Those matters aside, the facts are that the integrity of our imputation system as it stands in the Act today is more than adequately protected by a whole range of integrity rules to ensure that only distributions equivalent to realised taxed profits can be franked (s202-35); to ensure achievement of the objects in s204-1 by the anti-streaming rules in Div 204; and to ensure that the system cannot be manipulated in a way that the benefit of franking and the tax offset is directed to persons other than the true economic owners intended by the system to be benefited(see the various rules in Subdiv 207-F : Ss 207-145 to 207-160.)

That the proposed amendment is not an integrity measure,but a revenue saving measure, is confirmed by the fact that regular company distributions are not within its embrace; if raising capital to fund,directly or indirectly, franked distributions was a threat to the integrity of the imputation system, then the proposed measure would apply to all distributions, not just special distributions outside of regular distributions.

2. Retrospectivity

This concern does not really require elaboration. If the proposed amendment is merely a revenue saving mechanism as I suggest it is, then it's retrospective operation cannot be justified. A proposal to implement the Government's now abandoned policy of returning our imputation system to a true credit system would not be implemented on a retrospective basis, nor should a measure to put a brake on the cost to revenue of refunding taxable offsets to low or zero tax shareholders. That aside, the cost to ATO administration of applying this amendment on a retrospective basis over 6 years is likely to be significant.No doubt more than a few cases will be identified over the last 6 years by the Commissioner where he thinks, rightly or wrongly, they fall within the ambit of the proposed amendment. This will involve him in amending the assessments of thousands of shareholder taxpayers and collecting additional tax from these people. The cost of that alone would be significant, not to speak of the costs of litigation to both the ATO and taxpayers in disputing such claims, of which there will inevitably be some. The financial and other disruption and anguish this will cause cannot be properly measured, but will be a source of resentment going forward from people who have done nothing more than file their returns in accordance with the law.

3. The text and form of the legislation

Proposed s207-159 is written in the genre of an anti-avoidance provision ; cases clearly falling within anti-avoidance provisions, for example, where a company raises capital by the issue of equity interests and the funds so raised are used immediately to make a special franked distribution, are easily identified. It is cases at the margin or on the fringe which give rise to uncertainty and will inevitably give rise to disputation as to whether the proposed amendment will apply. The matter is complicated by the fact that money is fungible and if money raised as capital by the issue of equity interests is mixed with money which represents the general working capital of the company, it is impossible to say that the use of part of that pooled money to make a special

franked distribution is the use of the money raised as capital by the issue of equity interests, particularly where the moneys used to make a special franked distribution is less than the amount of its working capital immediately before the pooling. This is particularly the case with the large banks, which in the past have made a number of these special franked distributions as part of buybacks of their shares.

To take another example: A company raises moneys to fund a special franked distribution by quarantining its expenses from its revenues and borrows to pay those expenses. When it has sufficient moneys from the accretion of its revenues it makes the special franked distribution. It subsequently raises capital to repay the borrowing used to pay the expenses. In my view, no part of the capital raised is used ,directly or indirectly, to make the special franked distribution;that has been funded directly by revenues and indirectly by borrowing; it is the repayment of the borrowing which has been funded by the capital raised. But the Commissioner may take a different view.

In my respectful submission, proposed s207-159 is a very clumsy way of dealing with this matter and will inevitably give rise to unnecessary litigation or require companies to go to the Commissioner and seek a ruling each and every time they raise capital by the issue of equity interests; particularly if they have in the past made a special franked distribution or are likely to do so in the foreseeable future. But maybe this is the underlying intention of such legislation; to impel companies to go through such a clearance exercise or otherwise abandon special franked distributions going forward thus achieving the true purpose of this measure: to curb the loss of revenue caused by the refundable tax offsets that have to be made to zero and low tax shareholders.

It is not difficult to think of a couple of ways in which the text and form of proposed s 207-159 could be framed to bring absolute certainty to the issue of whether capital raised is to fund a special franked distribution.

Thank you for the opportunity to contribute.

Richard Edmonds

The Hon. Richard Edmonds , AM,SC