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Level 26, Governor Phillip Tower
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Sydney NSW 2000

9 December 2022

Director
Corporate Tax Policy Unit
Treasury
Langton Cres
Parkes ACT 2600

Email: OMSBBpublicconsultation@treasury.gov.au

TREASURY LAWS AMENDMENT (OFF-MARKET SHARE BUY-BACKS) BILL 2022

Dear Director,

On behalf of the 130,000 Wilson Asset Management investors, for whom we invest more than $5 billion, we are pleased to provide a response to the consultation on the proposed legislation relating to Treasury Laws Amendment (Off-Market Share Buy-Backs) Bill 2022.

We object to the proposed changes and believe they are unfair to Australian companies and all shareholders.

Off-market share buy-backs and selective reductions of capital are important and well-established capital management tools for Australian companies and their boards. Any changes to these proven practices would limit the capital management options available to Australian companies and have broad unintended consequences.

Under the proposed changes, a company would no longer be able to distribute fully franked dividends as part of the consideration paid to shareholders participating in an off-market buyback. Notwithstanding this, Treasury would still permanently eliminate all of the company's franking credits that would have previously been distributed in the off-market buyback *under the current laws* - despite these credits never having been distributed to shareholders.

This flawed and illogical policy appears to be an attempt to dismantle the franking system, which has underpinned efficient capital formation in Australia for decades. Unfortunately, if legislated, it will discourage Australian companies and investors from investing in Australia.

Disturbingly, the proposed changes have not been adequately or transparently communicated to Australians. They were added to the proposed legislation and were not announced in the Federal Budget on 25 October 2022.

We implore the government to not view this proposal in isolation, but rather to look at it in conjunction with the submission on Franked Distributions and Capital Raising (which closed for submission to your office on 5 October 2022). Together, these proposed changes undermine a system that has supported Australian companies and investors through more than three decades of recession free economic stability and growth.

During that time, the world has experienced several major macroeconomic events, including the Global Financial Crisis and the COVID-19 pandemic. The current system has protected Australian companies, and in turn their shareholders, through these times of economic instability, reducing companies' need to take on unnecessary debt. It has encouraged Australian companies to invest in and pay corporate tax in Australia and emboldened Australians to invest locally. This, in turn, has created more jobs for Australians and provided the additional income tax revenue that Treasury and Government are currently seeking.

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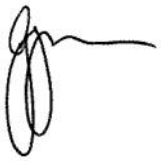
We believe that both of the proposed changes fail to recognise the fundamental principle underlying the dividend imputation system and the reason for its creation, being the avoidance of double taxation on company earnings. If passed, the proposed changes would unfairly target retail investors, low-income investors and superannuation beneficiaries, while limiting the ability of companies to effectively manage their own capital.

Treasury and the Government are underestimating the long-lasting and broad-reaching impact these proposed laws would have on Australia and we ask you to re-consider making any changes.

If you have any questions on our submission, please call me on (02) 9247 6755 or 0412 242 712, or email gw@wilsonassetmanagement.com.au or call Chief Financial Officer Jesse Hamilton on 0401 944 807 or email jesse@wilsonassetmanagement.com.au.

Yours sincerely,



Geoff Wilson AO
Chairman & Chief Investment Officer
Wilson Asset Management (International) Pty Limited

Jesse Hamilton
Chief Financial Officer

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A. Overview

The Federal Government's proposed policy for consultation, combined with the proposed legislation regarding Franked Distributions and Capital Raising, will have a significant impact on Australian companies and their ability to pay fully franked dividends to their shareholders.

We **STRONGLY DISAGREE** with the proposed changes to former Prime Minister Paul Keating's dividend imputation legislation, introduced to eliminate the double taxation of company earnings. The proposed policy put forward by the Government in the 2022 Federal Budget is illogical and inequitable to all Australians, and appears to be an attempt to dismantle the franking system.

The proposed changes will not impact high income earners or institutional investors. Those who will be hardest hit are the self-funded retirees and mum and dad retail investors. They are the honest, hardworking Australians, who have saved and invested their earnings in a portfolio of predominantly Australian companies, and rely heavily on the fully franked dividends paid to them. Any change to the franking system would be unjust.

The dividend imputation system was a key pillar of the Hawke-Keating economic reforms that have helped underpin three decades of recession-free economic growth in this country. It has also protected Australian companies through times of economic instability, reducing their need to take on unnecessary debt by providing a low cost of capital and the ability for them to raise money effectively and efficiently from their shareholders.

Not only does the franking system remove double taxation, it promotes economic stability. It encourages companies to invest and pay corporate tax in Australia and it emboldens Australians to invest locally, rather than overseas. This, in turn, creates more jobs – as well as the additional income tax revenue that Treasury and Government are clearly seeking.

By contrast, the proposed changes to the franking system would significantly disrupt capital markets, investment and economic growth in Australia. They would also risk the stability of the Australian banking system by inhibiting effective capital raising during challenging economic periods. Companies would face a stark choice: to reinvest in the growth of their businesses and the Australian economy, losing their tax paid and franking credits forever; or to reward their shareholders by taking on unnecessary risk and gearing up in order to distribute fully franked dividends.

The proposed changes have broad-reaching unintended consequences for Australia. If the two proposed legislation changes are enacted it will result in a significant accumulation of excess franking credits for Australian companies, which will discourage the payment of tax by some of our largest corporations and discourage Australian companies from continuing to invest in Australia.

In 2013, Keating pointed out that his dividend imputation system had revolutionised capital formation in Australia. He urged us to remain vigilant in protecting that system.

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B. Disrupting Off-Market Share Buy-backs

Off-market share buy-backs and selective reductions of capital are important and well-established capital management tools for Australian companies and their boards of directors. Any changes to these proven practices will significantly narrow the capital management options available to listed public companies. We believe that tax policy decisions should not have this practical effect.

Under the proposed amendments to off-market share buy-backs, Treasury is no longer allowing companies to pay fully franked dividends to participating shareholders as part of the buy-back consideration paid. Notwithstanding this, Treasury would still permanently eliminate all of the company's franking credits that would have previously been distributed in the off-market buyback *under the current laws* - despite these credits never having been distributed to shareholders.

The Government is not only further limiting a company's ability to distribute franking credits to shareholders; it is also proposing to permanently take those franking credits away from companies, denying them the ability to distribute legitimate tax payments made on behalf of their shareholders in the future.

The above changes were added to the legislation and were not announced in the Federal Budget on 25 October 2022. It is a significant negative addition which looks to further discourage Australian companies and investors from investing in Australia.

The proposed reasoning for this addition is flawed. Paragraph 1.23 of the Exposure Draft Treasury states that the reason for the debit to the franking account (i.e. the removal or elimination of franking credits in this instance) is so that "shareholders continue to benefit from imputation credits proportionate to their shareholding in the company after the buyback occurs".

However, there are no other ownership changes for Australian companies that result in a reduction of franking credits. Fundamentally, franking credits relate to tax paid by the company and should not be eliminated for changes in ownership. We believe that the proposed reasoning demonstrates a lack of understanding of the imputation system and that Treasury could establish a dangerous precedent for changes to a company's franking account for no legitimate reason.

It is important to note that Treasury is, on the one hand, limiting the ability of companies to distribute a fully franked dividend by way of an off-market share buy-back and telling companies they are still able to pay a special dividend and conduct an on-market buy-back instead. Yet, on the other hand, Treasury is implementing measures to deny companies the ability to pay shareholders fully franked dividends when, in Treasury's view, the fully franked dividend was directly or indirectly funded by any capital raisings, either before or after the payment of a fully franked dividend.

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C. Consideration of two legislation changes and long-term impacts to the franking system

We implore the government not to look at this proposal in isolation, but rather to view it in conjunction with the submission on Franked Distributions and Capital Raising (which closed for submission to your office on 5 October 2022). Together, these proposed changes undermine a system that has supported Australian companies and investors through more than three decades of economic stability and growth.

During that time, the world has experienced several major macroeconomic events, such as the Global Financial Crisis and the COVID-19 Pandemic. The current system has protected Australian companies, and in turn their shareholders, through these times of economic instability, reducing companies need to take on unnecessary debt. It has encouraged Australian companies to invest in and pay corporate tax in Australia and emboldened Australians to invest locally. This, in turn, has created more jobs for Australians and provided the additional income tax revenue that Treasury and Government are currently seeking.

Together, the proposed legislation changes will significantly restrict the ability of Australian companies to pay fully franked dividends aligned to off-market share buybacks and capital raisings, in turn;

- Reduce the effectiveness of the franking system and reintroduce double-taxation of corporate profits by stealth;
- Increase the cost of capital for all Australian companies;
- Destabilise the Australian economy and banking system;
- Negatively impact low-income earners, SMSFs and retirees who rely on fully franked dividends for income;
- Burden the welfare system by increasing the government's future funding obligations;
- Encourage off-shore investment;
- Encourage companies to explore avenues to avoid paying tax; and
- Encourage companies to gear up.

We recognise that the intent of the legislation proposed by the Federal Government is to prevent situations of intended tax avoidance and manipulation of the franking system by Australian companies.

However, the two proposed legislation changes being put forward 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. It could also interfere with the operation and the efficiency of the Australian capital markets and the structural integrity of our banking system.

The Franked Distributions and Capital Raising legislation, combined with the proposed changes to off-market buy-backs for companies appears to be a coordinated effort by Treasury to limit the ability of Australian companies to distribute fully franked dividends to their shareholders. In the running of either operating businesses or investment entities, it is normal and practical, from a working capital perspective, to generate a profit and invest the resulting cash flows productively (by purchasing further assets or applying the funds into the ongoing operations). Companies, their management and board of directors are expected to productively utilise shareholder capital at all times and not merely retain excess cash until such time as it is distributed to shareholders by way of franked dividends. In certain examples, the reinvestment of profits may be well outside the control of the company and its management. For example, a dividend paid by way of an in-specie distribution of an asset in lieu of cash, or a demerger that includes a deemed dividend component that is paid to the company.

This is part of routine company working capital management and has nothing whatsoever to do with tax avoidance and the manipulation of the franking system as Treasury and the Franked Distributions and

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Capital Raising legislation is suggesting. Any company that has legitimately generated and earned profits, and has paid tax on those profits, is entitled to distribute those profits and the associated franking credits to their shareholders.

The company's actions are merely those of generating and paying tax on profits, re-investing those profits, raising capital to take on the funding of those investments, and by so doing freeing up cash from its legitimately earned profits so it can pay out as a dividend to shareholders. This is not tax avoidance or the manipulation of the franking system and, in our opinion, the proposed Franked Distributions and Capital Raising legislation, now combined with the proposed changes to off-market share buy-backs for companies is a complete regulatory overreach.

The demise of the franking system, which would eventuate due to the application of the two proposed pieces of legislation in their current form, will significantly increase the cost of capital for all franked dividend paying Australian companies and drive Australian investors abroad or force them to invest in other asset classes outside of traditional equity markets.

In conclusion, we strongly object to the Treasury Laws Amendment (Off-Market Share Buy-Backs) Bill 2022 because alongside the Franked Distributions and Capital Raising legislation, it will lead to the demise of the franking system and are changes that are unfair to Australian companies and all shareholders.