CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006 Australia

GPO Box 2820 Melbourne
VIC 3001 Australia

P 1300 737 373
Outside Aust +613 9606 9677

cpaaustralia.com.au

Director
Corporate Tax Policy Unit
Treasury

Email: **frankeddistconsult@treasury.gov.au**

5 October 2022

Dear Sir/Madam,

Franked distributions and capital raising

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 170,000 members in over 100 countries and regions. We make this submission on behalf of our members and in the broader public interest.

The **Exposure Draft Treasury Laws Amendment (Measures for a later sitting) Bill 2022: Franked distributions funded by capital raisings** (ED) seeks to add distributions funded by capital raising to the list of distributions that are unfrankable.

Scope of the measure – potential to capture ordinary activities

While no mention of the origin of this measure is made in the **Exposure Draft Explanatory Materials** (EM), the **2016-17 Mid-Year Economic and Fiscal Outlook** (MYEFO) announcement sought to address arrangements identified in the ATO's **Taxpayer Alert TA 2015/2 Franked distributions funded by raising capital to release franking credits to shareholders** (TA 2015/2).

These were atypical arrangements where the ATO was, at the time, looking to apply the anti-avoidance rule in **section 177EA** of the *Income Tax Assessment Act 1936* or other anti-avoidance provisions. It was understood that the legislative response would be targeted and limited to a narrow set of circumstances.

However, members have expressed concern that the wording in the ED results in a far more expansive measure that goes beyond the parameters of the arrangements contained in TA 2015/2. There is the potential to capture ordinary capital raisings and capital management activities, creating significant uncertainty for taxpayers and their advisers. In particular, the term "practice of making distributions" contained in draft subsection 207-159(1)(a) raises questions as to how this might be determined and what forms and/or timings of distributions might be considered irregular.

The separation of the "principal effect" and "purpose" tests in draft subsection 207-159(c) also broadens the ambit of the measure as it requires only one of the tests to be satisfied. We suggest that the arrangements sought to be targeted by this measure would reflect both the principal effect of funding the relevant distribution or part thereof, and that the equity interests were issued for such a purpose. By disconnecting the two limbs, the prospect of the ATO questioning a wide range of commercial capital management activities arises, and tax uncertainty increases for businesses and investors.

Examples of ordinary activities that appear to be at risk of being captured by the measure include equity raising for acquisitions, dividend reinvestment plans, capital returns and share buy-backs. Such market activities are common and should not be unnecessarily impacted by uncertainty created by broad anti-avoidance rules.

We therefore recommend that the "or" between subparagraphs 207-159(1)(c)(i) and (ii) be replaced with "and", thereby better targeting the measure in line with TA 2015/2 and reducing market uncertainty about the prospect of franking credits being disallowed.

Impact on private groups – ability to satisfy conditions and tests

The wording of TA 2015/2 and the MYEFO announcement suggested that the measure was focused on publicly listed companies. We understand that the issue was related to capital raisings being used to release franking credits that were then claimed by shareholders, benefiting institutional superannuation funds in particular. In contrast, the concern about franked distributions to superannuation funds resulting in refundable franking credits is not present in private groups due to the limitations on private companies being owned by superannuation funds.

However, private companies are also captured by the ED introducing the risk of the measure being applied to arrangements beyond the intended target. The issue of establishing the "practice of making distributions" is particularly heightened for private groups where the pattern of or manner in which distributions are made is far more irregular than for public groups. Issues related to the "principal effect" and "purpose" tests are similarly exacerbated for private groups where the timing of events or the movement of funds between group entities may be incorrectly interpreted by the ATO as an attempt at tax avoidance.

In addition, within private groups, loans to private companies may be characterised as equity interests for tax purposes. While exceptions to equity interest are available under sections 974-75(4)-(6) in the *Income Tax Assessment Act 1997* (ITAA 1997), these may not always apply to at-call loans or similar financing arrangements used in this market. This then exposes these taxpayers to potential audits despite such arrangements being lower risk and not envisaged in TA 2015/2.

We query whether private groups were intended to be included in this measure, and if it may be more appropriate to confine the provisions to public companies. This ensures that the integrity risk related to public companies, renounceable rights and superannuation funds is addressed, while not creating uncertainty and increased compliance costs for taxpayers who are not associated with the targeted arrangements.

Retrospectivity – investor certainty

The measure is proposed to apply from the date of the MYEFO announcement being 16 December 2016.

In combination with providing the Commissioner of Taxation with the ability to amend assessments outside of the existing period of review, the potential disruption to companies and investors, particularly retail investors, is significant. It is unclear how adjustments would be made – for example, debiting the company's franking account and/or treating part of the distribution as unfrankable, or whether investors would receive adjusted distribution statements, potentially incurring franking deficit tax or requiring complicated adjustments, especially for trusts.

Given that the ATO has recently determined that "risk identification processes and assurance programs have confirmed these arrangements [in TA 2015/2] are no longer prevalent in the large public and multinational business population"[1], this suggests that the arrangements targeted by the ATO are already known and have been largely addressed. Therefore, retrospective application should be confined only to those cases that are currently open. Otherwise, the potential for retrospective application of a measure that is far broader than the arrangements targeted by the ATO raises concerns that many activities may now be subject to amendment by the ATO.

We also note that the problem of administering amendments to franked distributions will remain into the future. This is because the ATO would likely only apply the provisions post-lodgment, which is often sometime after distributions have been made and statements issued to investors.

New law guidance

The ED introduces new tests, conditions and terms which will require further clarification as identified above. We recommend that the EM contains further explanation of the scope of the measure and examples of targeted arrangements. Also, we recommend that the ATO prepare a Law Companion Ruling (LCR) and Practical Compliance Guideline (PCG) to provide greater clarity and certainty with respect to the interpretation of the provisions, the retrospective application of the provisions, as well as an indication of where the ATO will dedicate compliance resources.

[1] ATO, **Findings report Reportable tax position schedule Category C disclosures**, Funding special dividends and buybacks – Question 2 disclosures, 12 November 2021, viewed 1 October 2022

If you have any queries about this submission, contact Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

Dr Gary Pflugrath
Executive General Manager
Policy and Advocacy