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24th August 2007

The Board of Taxation
c/- The Treasury
Langton Crescent
CANBERRA
ACT 2600

Via email

Dear Sirs

Review of the Taxation Treatment of Off-Market Share Buybacks

Please find attached Australian Foundation Company's (AFIC) response to the questions raised in the Discussion paper on the above topic.

As you may know, AFIC has over 80,000 retail shareholders and has over $5.6 billion invested in the Australian share-market. We are active investors, who communicate frequently both with our shareholders but also with the companies that we invest in.

In summary, our response is as follows :

Off-market share buy-backs as are currently practiced in Australia unfairly stream valuable franking credits to certain classes of shareholders, rather than to all shareholders, and ignore the fact that franking credits are assets of a Company, and as such belong equally to all shareholders.

We observe the following :

1. The underlying reasons for the demand for Off-Market Share Buybacks is the ability of certain categories of share-holder to gain a refund of excess franking credits, and in many cases also realise a capital loss. This therefore results in a streaming of franking credits to these shareholders.
2. Franking credits have real value to most Australian investors, and as such are assets of the company. As assets, they belong equally to all share-holders, regardless of the share-holders ability to 'use' them. However as they are not valued as assets on the Balance Sheet, there is an erroneous perception that no value has been lost by selling these franking credits for less than their true worth.
3. The discount limit of 14% in an Off-Market Share Buyback places an artificial limit on the value that the market can attribute to the franking credits being sold, thus depriving shareholders who do not participate from getting full value for these assets. The scale-backs in recent buy-backs due to demand indicate that these franking credits are not being properly valued.
4. In order to access the franking credits which, as noted above, belong to shareholders, investors have to actually sell their shares. An Off-Market Share Buyback does not 'return capital to shareholders', as participants have to cease being shareholders to the extent that they sell shares into the Buyback. We regard an Off-Market Share Buyback as rather an opportunity for investors who

want to sell shares to do so. As long-term investors, we believe that it is inequitable that in order to access franking credits which rightly belong to us as a shareholder, we have to sell shares and then re-purchase them at a higher price to retain our holding.

5. Companies frequently ‘buy-back’ their shares as they view them as being undervalued on the market. Our preference is that companies should rather return the excess cash and franking credits to shareholders who can then determine whether they share that view (i.e. by reinvesting the dividend thus received).
6. Although many off-shore and domestic institutions appreciate the brief rise in share price due to the Earnings per Share accretion that often results from an Off-Market Share Buyback, this short-term accretion ignores the value of the franking credits foregone. This is widely acceptable to many institutions, as most fund managers ignore taxation (and franking credits) in assessing performance.

Yours sincerely,

Andrew Porter
Chief Financial Officer

APPENDIX A: CONSULTATION QUESTIONS

CHAPTER 2: BACKGROUND

Q2.1 The Board invites comment on the reasons companies, both listed and unlisted, use off-market share buybacks:

- How significant are each of the above explanations for the use of off-market share buy-backs ("OMSBBs")?

Fairly significant. In all cases, there are alternatives, so the question becomes as to why OMSBBs are more popular than the alternatives. Taking each explanation in turn:

  - *Return of excess funds. This can be done to all shareholders via dividends or capital returns.*
  - *Release of franking credits. This can be done via dividends, either special for 'volatile cash flows' or larger "normal" for cash-flows that are more likely to be 'permanent'.*
  - *Maintain a preferred capital structure. This can be done via capital returns or on-market buy-backs, or an off-market buy back that did not involve retained earnings and/or franking credits.*
  - *Signal that it believes its shares to be undervalued. This can be done via an on-market buy-back. The artificial discount in an OMSBB and the ability of nil and low-rate tax-payers to achieve an after-tax advantage actually distorts this message. AFIC's preference would be that companies return cash to shareholders who, if they believe the shares are undervalued, can reinvest that cash in the company's shares, rather than the company make that judgement on its shareholders behalf.*
  - *Increase earnings per share. This should not be an end in itself – however (see later) because of the importance of any short-term increase in EPS to those shareholders who measure the performance of their portfolio by it, it is a major cause of the pressure bought to bear on companies to do OMSBBs by large off-shore shareholders and larger domestic institutions.*
  - *AFIC has no comment on the ways in which companies may use off-market buy-backs to alter their share structure, or about the reasons why unlisted companies may use them.*

- Are there other reasons for the use of off-market share buybacks?

There are three major reasons for OMSBBs.
1. OMSBBs produce a short-term increase in Earnings per Share. Because EPS is used by most institutions (and research analysts) as a valuation metric, it will normally produce an increase in the valuation of the stock under this methodology, and also often a corresponding increase in share-price – again, short-term.
However, the EPS accretion ignores the loss of valuable franking credits.
Off-shore shareholders who are more interested in capital growth as opposed to dividends, and domestic institutions who measure total return on a pre-tax basis, and who measure portfolio success on short-term gains, will therefore pressurise companies to do OMSBBs for the brief increase in EPS and valuations that they provide. As they are not measuring portfolio

performance on either a long-term basis or on a post-tax total shareholder return basis (which would favour special dividends over OMSBBs) they will pressurise companies to do an OMSBB for the short-term comparative benefits that they provide.
2. The second major reason for the use of off-market buy-backs is that certain categories of shareholders (i.e. share-holders who pay less than a 30% tax-rate) who together will often make up a large part of many listed companies' share-holding base, like them for the taxation benefits they provide. These benefits greatly increase the post-tax return that they can make on the investment.
3. Due to the value of the attached franking credits to shareholders in 2. above on the dividend portion of an OMSBB, companies can normally buy-back shares cheaper through an OMSBB than they would be able to on-market.

When a Company therefore canvasses shareholders' opinion as to how to make capital/franking credit/profit returns, a significant proportion of its institutional shareholder base will ask for an OMSBB, whether for the taxation benefits that they provide for the low-rate taxpayer participants, or for the short-term increase in EPS and consequent share-price appreciation) for the off-shore and other larger institutional shareholder base. Additionally, investor classes best able to make use of the taxation legislation and those who benefit most from short-term increases in valuation will favour companies that frequently use OMSBBs as investments over companies that merely pay out larger proportions of their earnings and franking credits, thus increasing their share price/attractiveness in the market.

Advisors to Companies will not only point out the demand from the institutional shareholders, superannuation funds and nil/low rate taxpayers for the above, they will also argue that as franking credits do not appear on the balance sheet, by attaching them to dividends this enables companies to buy back shares cheaper than they would on-market (where they would not be able to use these franking credits, as no dividend is paid) at no cost to the Company or the non-participating shareholders. This is incorrect – franking credits are assets of the Company, and thus shareholders, even if they do not appear on the Balance Sheet.

Q2.2 The Board invites comments on the alternatives to the off-market share buybacks available to companies and the purposes for which they are used.

There are three major alternatives:

- *If a company believes its shares are under-valued, it can do an on-market buy-back. This will not normally involve retained earnings, but merely cash and a corresponding reduction in the number of shares on issue and the company's share capital account*
- *If a company genuinely has excess capital but no franking credits and/or retained profits, then a capital return can be made. This normally will have no taxation implications unless the capital return is larger than the pre-return tax cost base of the shareholder.*
- *If a company has franking credits and retained profits surplus to its normal "progressive dividend policy", a special fully (or partially)-franked dividend can be paid to all share-holders. This is by far the most attractive methodology for returning profits and the valuable franking credits to shareholders who wish to remain shareholders, and who measure total shareholder return on a post-tax basis over a longer period. An OMSBB means that only those who wish to sell shares, and who economically can benefit the most (for the reasons noted above), benefit. The argument that non-participatory shareholders benefit from the theoretical increase in earnings per share is a) unproven when compared to what they would have received*

via a special dividend; b) very short-term focussed and c) assumes that valuation for a share is based mainly on EPS rather than on a higher pay-out policy.

Q2.3 The Board invites comment on the reasons for the growth in the use of off-market share buybacks:

- How significant are the explanations given above in driving the growth of off-market share buybacks?

Very significant – the changes in taxation legislation to enable nil or lower-rate taxpayers (i.e. charities and superannuation funds) to reclaim excess franking credits, and for individuals and superannuation funds to claim capital losses is what has enabled certain categories of shareholder to benefit from off-market share buy-backs.

- Are there other explanations for the growth in the use of off-market share buybacks?

As noted above, the major reason for the use of off-market buy-backs is that certain categories of shareholders, who together will often make up a large part of many listed companies' share-holding base, like them for the reasons noted above. When a Company therefore canvasses shareholders' opinion as to how to make capital/franking credit/profit returns, a large proportion of its significant institutional shareholder base will ask for an OMSBB. It is interesting to note that there are now pressures from fund managers to report on an 'after-tax' basis, which will enable the taxation benefits to be factored into their performance and thus, presumably, enable them to collect on out-performance fees. As these will benefit super-funds at the expense of larger institutions that do not enjoy similar tax benefits, it remains to be seen whether this will become the standard.
It is worth noting that proprietary traders at investment banks are measured on a post-tax basis, recognising the importance of the franking credits – they, therefore, are usually more supportive of a special dividend whilst advisers to larger funds that measure performance on a shorter-term EPS focussed portfolio valuation model, and that ignore franking credits and taxation (although such items are of course relevant to their Australian resident unit-holders)will be more supportive of OMSBBs.

Q2.4 Are these the appropriate policy objectives to consider?

Yes, particularly in the consideration as to whether there is equity amongst tax-payers in the use of OMSBBs, and the current practice of dividend-streaming that the current system gives rise to, whereby dividends and associated franking credits are streamed away from corporates and higher tax-rate paying individuals to nil and lower tax-rate paying individuals and entities.

Q2.5 Are there other policy objectives that should be considered?

Consideration should be given as to whether the Commissioner 'debiting' a Company's franking account is in fact an appropriation of that Company's assets. Franking credits definitely belong to shareholders, like any other asset, and the legal standing of the Commissioner to appropriate them should be clarified.

Q2.6 Is the current balance between them appropriate?

Equity is the most important from a tax-payers point of view – efficiency and simplicity from a company's.

Q2.7 Are there particular linkages and impacts with other parts of the tax system that the Board needs to be aware of?

Listed Investment Companies ("LICs") are a separately identifiable entity under the Income Tax Assessment Act 1997. Currently, LICs, and in fact all corporates, cannot claim any capital loss that arises from an OMSBB, unlike individuals and superannuation entities. Consideration should therefore be given as to whether this anomaly should be removed, particularly as the original Subdivision 115-D relief for LICs to pay an LIC gain out of capital gains arising from the sale of investments was designed to put LICs on an equivalent basis to other investment vehicles (i.e. trusts). Extending the loss provisions would merely be a continuation of this.

CHAPTER 3: CURRENT FRAMEWORK FOR SHARE BUYBACKS

Q3.1 The matters outlined in the practice statement are relevant to the Board's review and the Board would welcome comments on them as part of this discussion paper process.

As noted above, franking credits should be treated as the assets of a company which they are. This would include a public disclosure by Companies and the Commissioner as to the amount of franking credits that have been appropriated under s177EA5(a).
AFIC has no further comments on the Practice Statement.

CHAPTER 4: IMPLICATIONS OF CURRENT TREATMENT OF OFF-MARKET SHARE BUYBACKS

Q4.1 Do off-market share buybacks generally result in more than a short-term increase in earnings per share? If so, for how long?

It is unlikely and unproven that that any effect will be other than short-term. If the capital being returned was truly surplus, then it would be earning less than the required Return on Capital, presumably, which is what will really drive any future EPS, and it is future rather than current EPS that should be used as one of the components of share valuation.

Q4.2 If so, is this beneficial, and to whom? Or are there measures, such as share prices, more important for shareholders?

Short-term EPS may be relevant to those who are measured by it, as noted above, but Total Shareholder Return, which includes both the movement in a Company's share price and the returns that it distributes to all shareholders is more relevant for on-going shareholders. Also, the after-tax position of shareholders (or unit –holders in the case of managed funds where the tax flows through) needs to be considered, hence the need to consider the value of the franking credits on a special dividend foregone in favour of an OMSBB.

Q4.3 Do off-market share buybacks facilitate capital management strategies?

Yes to the extent that they provide an alternative to special dividends or on-market buy-backs.

Q4.4 If so, are they more effective than other mechanisms for doing so, and why?

Any efficiency lies only in the ability of companies to buy back shares at a discount and assumes that such capital thus expended cannot generate greater returns within the company. It also ignores shareholder efficiencies in that a special dividend paid to all shareholders may be used to generate returns elsewhere whilst the shareholder can continue ownership of shares which they would have lost under an OMSBB.

Q4.5 Are there other implications for public companies, particularly when compared with other capital management strategies?

By concentrating on OMSBBs as the major capital management initiative, companies are assuming that they are not caught by Corporations Act legislation that explicitly states that dividends must be paid to all shareholders. They rely on ASIC guidance, which has not been tested in the courts. They also alienate shareholders who are unable to economically benefit due to the tax differential from OMSBBs or who do not benefit from the short-term increase in valuation caused by any uplift in EPS (which, as noted above, only benefits those who are rewarded under such measures, i.e. fund managers, or those who actually have to sell the stock to benefit from the gain). If all non-participating shareholders (in an OMSBB) who were not rewarded on the basis of short-term portfolio gains were given the choice between a special dividend and a marginal increase in EPS, then the special dividend would be chosen in the vast majority of cases.
Another major issue with using an OMSBB is that the Company is making a judgement that in current market conditions its share-price is undervalued. Our preference would be for Companies to return the cash (plus franking credits) to the shareholders who can then make that judgement themselves, by reinvesting the dividend in the Company's shares as appropriate.

Q4.6 Why are off-market share buybacks preferred over special dividends for the distribution of volatile profits?

As noted above, they are preferred because a significant, and voluble, section of the Australian shareholder base likes them due to the short-term valuation increase they provide compared to the rest of the market, ignoring the lost opportunity for increased returns via a fully-franked dividend, and others (eg superannuation funds) like the taxation benefits that they can access. They will therefore pressurise companies to undertake them. Similarly, they will invest in companies that are likely to do OMSBBs and/or have done so in the past.

Q4.7 Does the interaction between provisions for taxation of off-market share buybacks and employee share schemes work appropriately?

No response

Q4.8 If not, why, and what changes could be made to ensure a more appropriate interaction?

No response

Q4.9 Are there other implications of the current treatment of off-market share buybacks for unlisted companies and their shareholders?

No response

Q4.10 Are the current provisions easy for unlisted companies to understand and comply with? If not, what changes could be made to reduce compliance costs for unlisted companies?

No response

Q4.11 Do unlisted companies have difficulties in calculating the market value? If so, what might be some approaches for dealing with these difficulties?

No response

Q4.12 Should there be different taxation arrangements for off-market share buybacks for listed and unlisted companies?

No detailed response, but care should be taken to ensure that any outcomes do not inhibit private companies from going public, or enhance the attractiveness for a public company to go private.

Q4.13 Should the current arrangements be retained for unlisted companies, with any changes being made for listed companies only?

No response

Q4.14 Are there circumstances in which listed companies should be treated in the same way as unlisted companies?

No response

Q4.15 How should widely held unlisted companies be dealt with?

No response

Q4.16 Would separate regimes increase compliance and administration costs?

No response

<u>CHAPTER 5: ASSESSMENT OF CURRENT TAXATION TREATMENT</u>

Q5.1 Do off-market share buy-backs lead to efficient economic outcomes?

No – by taking value (i.e. retained earnings and franking credits) and giving them to a sub-section of the shareholder base that can best use them, due to current taxation legislation (effectively streaming the franking credits), means that this is not an efficient economic *outcome. Similarly, they can be seen to be driving short-term growth at the expense of longer-term total return.*

Q5.2 If so, do they do so more efficiently than other mechanisms for returning surplus cash?

More efficient outcomes would include special dividends as a method of returning excess profits and franking credits (but see below regarding discounts).

Q5.3 Why are they more efficient?

N/A

Q5.4 To what extent do the current taxation arrangements drive this outcome? Could the efficiencies be achieved without the current tax arrangements?

Current taxation treatments entirely drive the behaviour and the demand, to the extent that there would be no sellers into an OMSBB if it were not for the taxation advantages. If they were removed (i.e. franking credits not accessed and capital loss not claimable) they would be as equally efficient in all material areas as an on-market buy-back.

Q5.5 How do Australia's taxation arrangements for off-market share buybacks compare with those of our key trading partners?

The arrangements are not comparable due to Australia's franking legislation and the ability to reclaim excess franking credits.

Q5.6 Would changes to our taxation arrangements reduce competitiveness of our companies operating in international markets or make Australia a less attractive location for corporate operations? If so, how significant are the effects likely to be?

As the taxation arrangements are only of benefit to Australian residents, the competitiveness should not be reduced at all. However, if off-shore portfolios like to invest in Australia for the short-term out-performance that an OMSBB can give, then the attractiveness may be somewhat reduced. However, this ignores any longer-term and/or fundamental reasons for investing in Australian companies.
An exception to this is that companies may find it beneficial to have an Australian entity with Australian shareholders to enable them to buy-back shares at a discount to market using the current taxation arrangements, and this ability is currently affected by an artificial discount level- if the discount cap was removed, it is likely that the price at which shares would be bought-back (excluding franking credits) would be significantly lower than is otherwise the case.
In some cases it may act as a disincentive as overseas investors that may otherwise have received a dividend do not receive one as companies choose an OMSBB instead.

Q5.7 Are there other ways of addressing international competitiveness?

Any removal of the ability to do an OMSBB should have a short-term effect only. Enabling off-shore companies to access franking credits would do far more for the attractiveness of investment into Australian companies.

Q5.8 Is it appropriate that off-market share buybacks enable the optimal use of franking credits?

OMSBBs as they currently stand do not enable the optimal use of franking credits. Franking credits are assets of the company and its shareholders. To artificially stream them without getting full value for them means that optimal use is not being achieved.

Q5.9 How does this impact on the underlying policy of the imputation system of equal distribution of franking credits over time? In particular, what are the likely impacts on taxation revenue?

By streaming franking credits towards certain categories of tax-payers, the use of OMSBBs actively impedes the equal distribution of franking credits over time. By reducing the comparative attractiveness to companies of special dividends (which would in most cases be the alternative method of distributing "excess" profits and franking credits) taxation revenue is reduced as it streams taxable dividends away from corporates and higher-rate tax payers. Calculations of the loss of taxation revenue also seem to exclude the effects of superannuation funds (and other lower tax-rate paying entities) being able to claim a capital loss on the sale of shares into an OMSBB.

Q5.10 What are the advantages and disadvantages of these approaches?

a) Including franking credits in calculation of market value – this has the advantage of giving value to franking credits, but the disadvantage of not allowing the market to determine what the value of those credits should be.
b) Deny companies the ability to frank the dividend component – as noted this would essentially deny the attractiveness of an OMSBB over an on-market buy-back from those who currently most benefit, and force the companies down more equitable paths of distributing profits/franking credits – i.e. special dividends.

Q5.11 Are there other ways of reducing or eliminating the tax benefits associated with off-market share buybacks?

The Tax Commissioner could use Corporations Law to state that a dividend, if paid, must be paid equally to all share-holders, thus denying companies the ability to use realised gains, and thus franking credits. Alternatively, the ability to reclaim excess franking credits by participants in an OMSBB could be denied in these specific cases.

Q5.12 If there is not a separate regime for unlisted companies, what would the implication of these approaches be for those companies?

No response.

Q5.13 Do non-participating shareholders benefit from off-market share buybacks?

Under the current system, not in the long-term. The argument that non-participants benefit from an increase in Earnings per Share is misleading. Share price valuations consist of many factors – current EPS is a minor one, and very short-term. When any increase in EPS purely from an

OMSBB, and theoretical increase in value, is measured against an actual increase in Total Shareholder After-Tax Return by the inclusion of special dividends that would otherwise have been paid, it should be of far less value to non-participating shareholders.

Q5.14 Under what conditions would this be the case?

If the company, and therefore the remaining shareholders, got full value for the franking credits being streamed, this would alleviate part of the economic loss non-participants suffer by being denied a special dividend. In other words, if the artificial discount limit of 14% was removed, companies would be able to buy-back their shares at a much cheaper rate which would allow the market to determine the value of those credits.

Q5.15 To what extent do off-market share buybacks limit the ability of companies to frank future dividends?

Prima facie, it must limit the ability as the company no longer has the franking credits. It certainly limits a company from being able to pay out special dividends, and may well limit a company paying out 'progressive' dividends in the case of a number of earnings downgrades (note that most if not all OMSBBs under current legislation have been done at a time of continuing record company profits). Research that states that it does not impede a company's ability to pay out future franked dividends ignores the alternatives (i.e. special dividends or larger dividends) that may have been available if an OMSBB had not been selected as a means of distribution by the company.

Q5.16 Does the market attribute value of franking credits?

It is apparent that there is a value in franking credits – in acquisitions, companies that have franking credits are valued more highly than those without. The current methodology for OMSBBs denies the ability of the market to fairly value franking credits due to the artificial discount cap.

Q5.17 Are there possible market mechanisms that could address any inequities between shareholders? If so, what are their advantages and disadvantages? Are there any impediments to their development?

As noted above, the removal of the artificial 14% discount cap would go some way to addressing the inequities of the current system, as would the allowance to LICs, and other corporates, of the ability to claim a capital loss on participation in the buybacks. However, the only way to ensure total equity is to deny the ability to companies to stream dividends and franking credits to nil and lower-rate taxpayers, by either insisting that dividends must be paid to all shareholders or denying the company the ability to frank profits used in OMSBBs, which would remove their attractiveness.

Q5.18 Should investors be able to buy shares following the announcement of a buyback and participate in the buyback?

Under the current system, there is an argument that by doing so produces an increase in share-price which enables non-participants to extract a higher price should they wish to sell on-market, but this effect is only temporary, and does not benefit shareholders who wish to remain *shareholders. Should the artificial discount cap be removed, it would be imperative that investors be able to buy-shares to participate in order that full value for the franking credits be achieved during the tender process.*

Q5.19 If not, how could this be prevented? In particular, would there be issues associated with anticipatory trading?

N/A

Q5.20 In what circumstances should section 177EA apply?

S177EA should not be applied – it is a misappropriation by the government of a company's, and therefore a shareholder's, assets.

Q5.21 Should companies be required to disclose the impact of an off-market share buyback on their franking account balance?

Yes. Current accounting standards (AASB 101) outline the information to be included in a Company's accounts and this could be expanded. Companies should also disclose the amount debited under s177EA(5)(a) in their announcement to the market upon completion of the buy-back.

Q5.22 Should there be a cap on the level of discount in a tender-style off-market share buyback? If not, why not and what might the implications be?

There should be no cap. This would allow the market to determine the value to be placed upon the franking credits. The current cap ensures that the nil and low-rate taxpayers are unfairly advantaged in being able to make use of the franking credits, and that the non-participating shareholders, through the Company, do not receive full value for the franking credits.

Q5.23 If a cap should be retained, is 14 per cent an appropriate maximum level of discount to deny franking credits to participating shareholders? If not, how should the acceptable level of discount be determined?

N/A – cap should not be retained.

Q5.24 Should franking accounts be debited for resident-to-resident streaming? If not, why?

No – see above. The Commissioner should either accept that there is streaming of franking credits in an OMSBB, which currently exists due the economic advantages that it provides to nil and low-rate tax payers, and therefore remove all use of anti-streaming legislation in OMSBBs, including s177EA(5)(a), or act to prevent streaming by denying the use of franking credits in OMSBBs (or as noted above, insist on the strict interpretation of Corporations Act legislation and require profits and dividends to be paid out to all shareholders equally).

Q5.25 If so, what would be an appropriate methodology for calculating resident-to-resident streaming?

N/A – see above.

Q5.26 How could the Tax Office identify company shareholding patterns?

The Tax Office could use the same legislation that allows certain interested parties to see through nominee companies to the underlying beneficial owners.

Q5.27 Would it be appropriate to use some proxy measure to overcome timing difficulties?

N/A

Q5.28 How could nominee issues be dealt with?

See above.

Q5.29 What is the appropriate methodology or methodologies for determining the capital/dividend split?

Companies should be allowed to determine the split. However, this is only effective if the discount cap is removed, allowing the franking credit on the dividends that would then be determined by the company to be valued by the market, as otherwise even more franking credits are being disposed of too cheaply. An alternative is to use the most recent publicly available information, or a company's most recent estimate, of the ratio of share capital to retained earnings/distributable reserves that the company has, and split the capital/dividend element that way.

Q5.30 Should the methodology vary depending on the circumstances? If so, what circumstances should a particular methodology be used?

If taking the alternate approach noted above, i.e. proportionate split, then methodologies will need to change depending upon the types of reserve used, whether franking credits can be used on 'dividends' being distributed from certain reserves etc.

Q5.31 Should the methodology be specified in the tax law? What should the consequences be of a split that differs from the methodology?

If proportionate split, then yes. If the split used then differs, franking should be denied on the proportion of 'dividend' that would otherwise not have been paid.

Q5.32 Is it appropriate for shareholders who receive tax free dividends also to realise a capital loss by participating in an off-market share buyback?

No – if shareholders who receive a tax-free dividend are nil rate tax payers, they have no taxable gains to set the losses against. However, LICs and corporates and other tax-payers should be able to access the capital loss.

Q5.33 If not, how should double taxation be prevented in this situation?

N/A

Q5.34 Should the same treatment be provided for both listed and unlisted companies?

Yes – see 4.12

Q5.35 How could the compliance and administration costs of the provisions be reduced?

If OMSBBs are allowed to continue in their current form, 'safe harbour' legislation can be enacted which would enable a standard OMSBB to be quickly processed without the need for private rulings.

Q5.36 To what extent should current Tax Office practice, as outlined in its practice statement, be specified in the tax law? Are there any issues or difficulties with doing so?

There are inconsistencies between the law and practice (see below). Trying to necessarily include everything in a practice statement in legislation would involve further expense and overhead from companies and shareholders as attempts are made to ensure that all aspects of the legislation are complied with. By including the 'guidance' in a Practice Statement, it should enable greater flexibility.

Q5.37 Should there be a specific provision for dealing with dividend and/or capital streaming in the context of off-market share buybacks, rather than relying on more generic anti-avoidance provisions?

As noted, there is an inconsistency in that legislation expressly forbids franking credit streaming, whilst OMSBBs do exactly that. The Commissioner effectively ignores the inconsistency in this case. If OMSBBs are to continue, then the anti-streaming legislation needs to be rewritten to expressly allow streaming in the case of OMSBBs.

Q5.38 Does the current approach to calculating the market value cause any difficulties? What might the alternatives be?

No difficulties noted.

Q5.39 How could the provisions be simplified to assist unlisted companies and smaller shareholders to understand their operation?

No comment re unlisted companies. With regards to shareholders, companies could show the effect of participating in an OMSBB on the following classes of shareholder, using a uniform tax cost-base for shares and (if the discount cap is removed, and estimated discount at various levels), and for each shareholders the effect where they had brought-forward gains to set off a loss against, and where they had none, in a tabular format:

Nil tax-payers (i.e. charities)
Superannuation funds
Corporates (LICs separate if necessary)
0%, 15%, 30%, 40%, 45%