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GRSJ:JHW
20 August 2007

The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs

Taxation Treatment - Off-Market Share Buy-Backs

I refer to the recently-issued Discussion Paper and the invitation therein to submit written submissions. Having attended the consultation forum of 31 July 2007 in Melbourne, I note the following.

As opposed to addressing aspects of the Corporations Law covering buy-back provisions as well as the distribution of dividends to shareholders, and Directors' responsibilities in relation thereto, it seems to me that the thrust of both the Discussion Paper and the discussion itself was heavily biased towards the detail of these buy-backs, with little attention given to background fundamentals.

I must say that I was surprised to see among those overseeing the discussion one Karen Phin of UBS who clearly has a major financial interest. I was left with the impression also that those in attendance – as demonstrated by the organisations which they represented as well as questions asked and discussed – reflected an interest in or involvement with the current taxation benefits.

It is appropriate that the Terms of Reference and the very fact that the enquiry has been set up by the Government as a "Board of Taxation" clearly puts the focus on the taxation aspect. However, among matters which the Board is to take into account are points which quite clearly must involve the underlying relevant Corporation Law, which quite simply is covered by "any other matters the Board considers to be appropriate".

Whether or not Directors are in breach of their duties under the Corporations Law and whether or not the Law is in need of review would, I submit, require consideration under this point.

In making this submission, I request that you have regard for all previous communications, not only in personal discussion but:

- letters from me addressed to Mr J A Emerson (Member, Board of Taxation) and Mr R F E Warburton AO (Chairman, Board of Taxation);
- copy letters which I have submitted to the Attorney General;
- copy letters which I have submitted to the ASIC;
- copy letters which I have submitted to the ATO;
- letters of mine published in the Australian Financial Review;
- letter published in the Aust Financial Review by SEK Hulme, QC;

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- letter published in the Aust Financial Review by one-time Editor of the AFR, V J Carroll;
- articles by prominent financial journalists – Terry McCrann, Alan Kohler;
- paper prepared by me for presentation to Melbourne Centre for Financial Studies;
- details of two surveys of typical private investors – each of which showed that approximately 97% disapproved of the manner in which the major portion of the consideration for off-market buy-backs was in the form of a franked dividend, with the preference being expressed for an enhanced dividend and/or capital return. (The structure of these surveys and the interpretation of the response was judged to be fair and reasonable by Roy Morgan Research.)

The fact of the matter is that off-market buy-backs structured in the manner under discussion are quite clearly in breach of the intention of the Law and, in as much as directors are failing to treat shareholders equitably, are at odds with their legal obligations. The dividend component is in fact a "dividend" in the eyes of the ATO – and has all the critical earmarks of a dividend – but is said **not** to be a dividend by the ASIC. These and other pertinent aspects have been carefully argued in great detail without a satisfactory response from the ASIC.

The Corporations Law states, Section 254W, that dividends must be for the same amount for each share. It has nothing to say about, or make any distinction regarding, a "deemed" dividend or a "franked" dividend or any other sort of "dividend". Further, the Act requires that off-market buy-backs must be fair as between shareholders and be for the same proportion of each holding. The clear intention of this requirement is conveniently circumvented by the structuring not as a buy-back, but as an invitation to sell-back!

In defence of its position, the ASIC has argued that shareholders are in favour. This is said to be supported by the result in two instances where resolutions were put to the vote and the vote was in favour. It is common knowledge that the vast majority of shareholders see no point of voting on such issues and, without careful analysis of the percentage of the number of shareholders who voted and the percentage of the capital which they represented, this conclusion (as I suspect) would fall into the deceptive and misleading category. In this regard, the ASIC appears to prefer to ignore the results of the surveys of mine mentioned above.

Among the numerous observations which I have presented, you will see that I have commented upon the perceived notion that somehow "franking credits" would be "wasted" if not "used up" in this manner, and this is seen as justification. The absurdity of this is illustrated by the fact that the franking credits would only be used up if 100% of tax-paid retained profits were distributed by way of dividend and, of course, in 99% of cases, this is never the situation and was never envisaged by the introduction of the concept of dividend imputation.

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Quite obviously, the intention was to address the previous circumstances where company profits were taxed twice – once in the form of company tax, and a second time as income tax in the hands of recipients of the dividends. As a consequence of manipulation of the intention of the Law, the ATO finds itself in a position of having to accept that the consideration for the disposal of a capital item can be a minimal component of "capital" and a major component (sometimes the order of 90%) in the form of a "dividend" with the taxation of the latter being that applicable to dividends and, in many instances, a totally fabricated capital loss offsettable against otherwise taxable capital gains.

The utter absurdity of the current situation has resulted in a windfall pay-out from the ATO to nil or low tax-paying shareholders (who often join the register for only a matter of weeks in order to participate), in effect subsidised by the vast majority of shareholders who find their equitable share of retained profits with attendant latent asset of franking credits plundered and gone forever.

As has been pointed out, the supposed trade-off in terms of the earnings per share argument is not only irrelevant but is never quantified and often presented in a deceptive and misleading manner. A theoretical increases in earnings per share of perhaps only 2.5% is supposed to compensate non-participants, while short-term shareholders profit to the tune of 15% to 17.5% within a few weeks and at their expense and continuing disadvantage.

From a legal viewpoint, the questions for directors are:

- Is there a benefit consequent upon the buy-back decision?
- If so, does the benefit fall equitably as between all shareholders?

The answer to the second question is quite obviously that it does not, which must put directors at serious risk of being in breach of their duties under the Law.

I again point out that the views which I have consistently expressed are supported by those who are or have been at the very highest level, in terms of experience and qualifications, among the legal fraternity (including the Judiciary), chartered accountants, the Securities Industry, as well as senior financial journalists and various others. It is a source of constant amazement that inaction by the ASIC has given sufficient comfort to allow company directors – no doubt pandering to the largely-Institutional shareholders – to persist with this artificially contrived concept.

I submit that the Board of Taxation, the mandate of which is to review the taxation treatment, should go past the 134 pages which appear to concentrate on the tax aspects, and address "any other matters", ie, the legal ramifications in reaching its conclusions. After all, hundreds of millions of dollars are consistently being stripped out of Consolidated Revenue in a manner never envisaged by the introduction in 1987 of Imputation of Company Tax. It is occurring only because vested interests are able to circumvent the clear intentions of the Corporations Law (and quite probably the letter of the Law) with the tacit approval of the ASIC.

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The purpose and correct interpretation of the Law would see these buy-backs abandoned, with the obvious consequence being a saving to Consolidated Revenue of hundreds of millions of dollars.

As indicated above, this submission should be considered along with the material referred to. Should you require further copies, I should be able to assist.

Yours faithfully

G R Sellars-Jones