31 March 2023

The Committee Secretary

Senate Standing Committees on Economics

PO Box 6100

Parliament House

Canberra ACT 2600

Lodged Online

Dear Sir,

Treasury Laws Amendment (2023 Measures No. 1) Bill 2023 [Provisions]

On behalf of the Institute of Public Accountants (IPA), I submit to you our comments on Schedule 4 of the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023 [Provisions].

The IPA is one of three professional accounting bodies in Australia, and a member of the International Federation of Accountants. It represents more than 50,000 members and students in more than 100 countries around the world.

In Australia, small businesses account for roughly 98% of all businesses, and are responsible for 32% of the total economy. More than 75% of IPA members work with or advise small businesses, and small to medium enterprises.

As such, we welcome the opportunity to provide feedback and make the following comments for consideration specifically in relation to Schedule 4 of the Bill.

Schedule 4 to the Bill implements the ‘Improving the integrity of off-market share buy-backs’ measure from the 2022-23 Budget by aligning the tax treatment of off-market share buybacks undertaken by listed public companies with the tax treatment of on-market share buybacks.

The IPA supports the principle of aligning the tax treatment of off-market share buybacks undertaken by listed public companies with the tax treatment of on-market share buybacks.

The streaming advantages of off-market share buybacks is an anomaly in our tax system. Franking credits belong to all shareholders, and streaming credits to a particular shareholder class is usually prohibited as it is inequitable and inconsistent with the fundamental principles of our imputation system.

It is for this reason that streaming of franking credits to a particular class of shareholder is generally prohibited. There are several complex anti-avoidance provisions which specifically prohibit the streaming of franked distributions to certain groups of shareholders.

If a company pays tax, it will credit its franking account. If it decides to pay a dividend, it will attach franking credits to the dividend so all shareholders can take advantage of the tax that has been paid on the income that the dividend was sourced from. This a fundamental principle of our dividend imputation system.

On-market share buy backs are treated differently for tax purposes because the proceeds are on capital account, which results in either a capital gain or a capital loss.

Off-market buyback proceeds for shares bought back consist of a capital amount, and fully franked dividend with differing tax outcomes depending on the shareholders cost base for the shares sold, and their overall marginal tax rate.

Off-market share buybacks are one of the few exceptions where streaming is permitted, and listed entities have been exploiting this at the taxpayers' expense.

Shareholders who can most monetise the franking credits attached to the dividend as part of the proceeds of the share buyback are incentivised to opt into the buyback offer. While all shareholders are allowed to participate, this tax advantage only benefits a certain class of shareholders, and by default off-market schemes effectively allow the streaming of these franking credits to low or zero tax shareholders.

Shareholders that don't participate in off-market share buyback (usually conducted as on an opt in basis) are generally not disadvantaged as the company can buyback the shares at a market discount so that earnings can be accretive going forward.

In 2018, the off-market buyback price for BHP was $27.64 when shares were trading at $32.14. The value attached to the excess franking credits when received by a certain type of shareholder more than makes up for the on-market price shortfall, had the shares been sold on market.

Large listed entities that have conducted off-market buybacks usually have to scale back such offers due to oversubscribed interest particularly from shareholders who can maximise the benefit of excess franking credits that are generated from participation.

For non-resident shareholders, franking credits have no value. So, missing out isn't an issue for this class of shareholder. Companies that undertake buybacks are required to debit their franking account for franking credits that would have been lost to dividends paid to non-residents, but the debit doesn't fully compensate for the streaming effect between high and low/zero tax rates for domestic shareholders.

Refunding excess franking credits comes at a substantial cost for government revenue. Anyone that doubts this should look at the academic research by Emeritus Professor Christine Brown from Monash University and Professor Kevin Davis from the University of Melbourne. **(***Tax-driven Off-Market Buybacks (TOMBs): Time to Lay Them to Rest published in Australian Tax Forum 2020)*

The cost to the taxpayer is a function of the size and number of buybacks that have happened during a particular period. The Treasury treats off-market buybacks as a form of tax concession in its expenditure statements, but it's difficult to calculate the real cost of this concession because of the complex assumptions required to guesstimate the true cost of shareholder who are eligible to participate in the buyback.

When the government is running a structural deficit all tax concessions should be evaluated to see whether they remain fit for purpose. Companies have many other options for undertaking other capital management initiatives like pro-rata capital distributions, special dividends, and on-market buybacks, so it is not as though this is the only mechanism of returning excess cash to shareholders.

The current policy of refunding excess franking credits supersizes off-market share buyback opportunities at the publics expense and it is for this reason that we support the alignment of tax treatment with on market share buybacks.

If you would like to discuss our comments, please do not hesitate to contact me.

Yours sincerely

Tony Greco

General Manager, Technical Policy

Institute of Public Accountants