

14 April, 2014

General Manager,
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

By email: taxlawdesign@treasury.gov.au

Dear Sir/Madam

**DRAFT AMENDING LEGISLATION AND EXPLANATORY MEMORANDUM – PREVENTING
DIVIDEND WASHING
COMMENTS BY STOCKBROKERS ASSOCIATION OF AUSTRALIA**

The Stockbrokers Association of Australia Limited (“the Stockbrokers Association”) provides the following comments to Treasury on the Draft Legislation and Explanatory Materials regarding the Prevention of Dividend Washing.

Preliminary Comments

The Stockbrokers Association has previously acknowledged the Government’s concerns at the potential for any mechanisms which could cause abuse of the dividend imputation system.

The introduction of the dividend imputation system has been one of the biggest contributors to the strength of Australia’s equity markets and the fostering of investment in Australian business enterprises in recent times. Its importance should never be underestimated. For this reason, as a general matter, the Stockbrokers Association is strongly supportive of maintaining the current system, and does not support conduct which could undermine or jeopardize the integrity of dividend imputation.

Set out below are a number of comments regarding the Draft Legislation and Explanatory materials.

PROPOSALS

Commencement Date

The Association notes that the Amendments are scheduled to apply retrospectively, taking effect from the 1 July 2013, being the date of the announcement by the Government that it would take action in respect of dividend washing. The Association agrees with the decision not to apply the provisions retrospectively prior to 1 July 2013, as was originally a possibility under the prior proposals. We note that the Association in its previous Submission in respect of Draft Determination TD 2014/D1 dated 11 February 2014 argued quite strongly that it would have been most unfair in the circumstances to have applied retrospectivity to a date earlier than the date that the Government signified its intentions.

We are therefore very concerned at reports that we have received from quite a number of stockbroking firms that they and their clients have received investigation notices from the Australian Taxation Office relating to potential dividend washing transactions going back four years.

We appreciate that the ATO is a separate agency, and that its operational matters are not connected with the current legislative drafting exercise being undertaken by Treasury. Nevertheless, the present steps to amend the legislation being undertaken by the Government should be determinative of the issue, and it is most unsatisfactory for there to be action taken by ATO which is not consistent with the legislation on such a fundamentally important issue. We wish to draw this to Treasury's attention in this Submission, and will be separately taking the matter up through other channels.

Absence of time limit on the two transactions

There is no time limit specified in the draft amending legislation between the sale and purchase transactions. Hence, there is the potential for two transaction to be impacted notwithstanding that there may be a significant time between them. This can have a material impact on transactions between parties who are deemed to be connected (see the comments below).

Whilst the draft legislation links the two transactions in terms of their dividends arising from a distribution of the same source of income, there are also issues with this approach (see the comments below).

Linkage to Corresponding franked distribution

The proposed amendments are drafted by reference to a linkage to a “corresponding franked distribution”, such that franking credits will be denied in relevant situations where they relate to dividends from the same income source.

Whilst this may be workable from the point of view of the ATO ascertaining which franking credits are to be denied, it is not at all workable in terms of taxpayers knowing whether or not they are able to enter into a transaction. It is difficult to know how a taxpayer could ascertain whether two dividends are from the same income source.

Scope of Draft Legislation Excessively Broad

We note that the proposed amendments will apply to relevant transactions in the cum and ex dividend markets not just by the taxpayer but also by connected entities of the taxpayer, regardless of any intention of any of the parties to engage in dividend washing.

The result of this drafting is to apply the prohibition excessively broadly, and to situations where its application would be unfair to the taxpayers concerned.

Whilst we appreciate the difficulty of drafting legislation to deal with this issue, to draft it so broadly does not, in our submission, lead to a fair outcome.

It is our understanding that the connected entity definition will capture relatives of the taxpayer, including distant relatives such as nephews, nieces, spouses and lineal descendants.

To apply the prohibition whenever two parties in such a broad universe transact in the relevant circumstances, without any requirement for an intention to engage in dividend washing, or without any need to establish that the parties has any knowledge of each other’s actions, is simply too broad. It is quite foreseeable that parties in such a broad group may be quite unaware that of the other’s actions. There needs to be more of a relevant connection between the parties’ conduct established in the legislation for the denial of the franking credits to apply.

In relation to group companies, there are many examples where two entities in a corporate group will transact for independent reasons. In a stockbroking context, for example, one company may buy or sell shares as part of an arbitrage trading strategy, such as index arbitrage, whilst the same or a related entity may transact in the opposite direction, for example, as a hedge for a derivative exposure, and may need to purchase cum dividend stock in order to do so. These transactions appear liable to be caught,

despite the fact that there is demonstrably no intention to transact for the purpose of dividend washing.

In our submission, the draft legislation should establish a requirement for a dividend washing purpose or arrangement or knowledge thereof for the legislation to fairly apply.

We would be happy to discuss any issues arising from our submissions on this issue. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au

Yours sincerely,



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