AUSTRALIAN LISTED INVESTMENT COMPANIES ASSOCIATION

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Mr Gerry Antioch
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via email to TaxTransparency@treasury.gov.au

"Improving the transparency of Australia's business tax system" – Discussion Paper April 2013

Dear Mr Antioch,

Thank you for the opportunity to comment on the proposals included in the above discussion paper.

The Australian Listed Investment Companies Association ("ALICA") is the industry body representing many of Australia's traditional Listed Investment Companies. ALICA's member companies have responsibility for the savings of over 200,000 predominantly retail shareholders, investing on their behalf in most cases in listed Australian and New Zealand companies. It is expected that some, at least, of ALICA's member companies will be affected by the proposals contained in the discussion paper.

Executive summary

ALICA supports the development and promotion of frameworks to allow the sharing of clear and useful information to all of its stakeholders, and is committed to improving the transparency of its activities.

However, ALICA is concerned that that the current proposal effectively shows the amount of income tax that is paid as a proportion of total and/or taxable income, but does not take into account the fact that companies may receive distributed income that has already been taxed when generated by another entity.

The dividend imputation rules were introduced to prevent this double taxation of the distributed income of corporate tax entities (i.e. once when it is received by the entity and again in the hands of the members on distribution).

The current proposal does not take account of the operation of the dividend imputation system. It does not recognise that tax may have already been paid on income distributed by other corporate tax entities. Consequently, it will produce information that is completely misleading to users that do not have access to the underlying components of income. This is particularly the case for companies like ALICA's members that derive such a large part of their income from the receipt of franked dividends.

ALICA also queries why "total income" (gross income) is proposed to be disclosed rather than "net profit or loss" as income tax is due on the taxable income of a company (which is a net concept), rather than the gross income. To use only the gross income figure would ignore the expenses and the profitability of companies, which would further confuse potential users of the information. For transparency purposes, ALICA would argue that the 'total profit or loss' figure in the Company Income Tax Return disclosures would be a more relevant figure than 'total income'.

Detailed comments

Please find below our detailed comments on the Discussion Paper proposals contained in *Section 2 – Transparency of Tax Payable by Larger and Multinational Businesses.*

Our understanding of the current proposal as it would apply to ALICA's members

Under the proposals in relation to the 2013-14 and later income years, the Commissioner would publish (if they met the income thresholds) a member company's name, ABN, total income, taxable income and the amount of income tax paid or payable for the relevant year.

Generally, the accounting income and the income tax expense are obtainable from ALICA's member company's Annual Reports, which as listed entities are freely available on their websites or as released to the ASX. ALICA therefore has no issues with the proposed disclosure of information obtained from income tax returns, which is largely the same as the information contained in the Annual Report (but is not identical as is explained below).

As companies domiciled in Australia and which do not have any international operations, there are no material distortions caused by overseas taxation.

As noted above, ALICA is concerned, that the current proposal regarding the publication of income tax paid by an entity, does not take into account the effects of the imputation regime and may therefore produce information that would be misleading to users. It will also result in figures being disclosed as taxable income (which has been received via franked dividend) upon which tax has already been paid by another company. This will result in taxable income effectively being shown twice – in the company that generates it originally and in the company, like ALICA's members, that receives it via a franked dividend.

This can be best illustrated using the information set out in an illustrative example of an LIC ("the Company") which receives a large proportion of its income via franked dividends.

	Previously taxed distributed income received from other corporate tax entities (i.e. franked dividend income) ($)		Unfranked Dividend or Income/expenses generated directly the Company ($)		Total ($)
Franked Dividend Income Received	200,000,000		-		
Other Income	-		30,000,000		
Total Income	200,000,000		30,000,000		**230,000,000**
Cost of Sales/Expenses	-		(21,000,000)		
Total Profit	200,000,000		9,000,000		**209,000,000**
Franking Credits Received - i.e. income tax already paid	86,000,000		-		
Taxable Income	286,000,000		9,000,000		**295,000,000**
Income Tax due from the Company	-		**2,700,000**	**A**	
Income Tax paid by other corporate tax entities	**86,000,000**	**B**	-		
A + B					**88,700,000**

The Company can be seen from the above to be only generating $9,000,000 of income upon which it has to pay tax, whilst $286,000,000 of income (including the tax paid thereon) has been imputed, or passed through to the Company, which in due course passes it through to its own members via a dividend.

Based on the current proposal and the above example the following disclosures would be made:

Table 1

Name	**ABN**	**Total Income**	**Taxable Income**	**Income Tax**[1]
The Company	XX	$230,000,000	$295,000,000	$2,700,000

1 Tax Payable has been based on item T5 of the Calculation Statement of 2012 Company Tax Return Form

ALICA notes that if there were sizeable capital gains during the year the difference between total income and taxable income would be even greater as capital gains are part of taxable income but not total income, and ALICA accepts that this would be another example of different disclosures for accounting and taxation.

The Company's profit would be $209,000,000. The difference between this figure and the taxable income relates to the gross up required for franking credits attached to the dividend income that the Company received and for which a franking offset is available.

The majority of the Company's income was derived from franked dividends, in other words from distributions from companies that had already paid tax (and who as noted above under the proposals would also potentially have their taxable income and income tax positions published). The actual tax payable figure for the Company would therefore be only $2.7 million. That is, the tax payable number which would be disclosed by the Commissioner under the current proposal is based on the tax payable after allowing for the franking offsets. Therefore, the tax payable does not reflect a comparable reference point to the amounts that are included in total income and taxable income.

Based on the table above, the Company's published income tax figure would be 1.2% of the total income figure, 0.92% of the taxable income figure and 1.3% of the profit figure.

The reasons for this seemingly low proportion of tax payable would be clear to users of the Company's financial statements and to its shareholders and those familiar with its activities.

ALICA is concerned that the publication of these figures in isolation would be seriously misleading to users who do not have an understanding of the components of an LIC business, and may cause adverse publicity and uninformed comment.

Therefore the outcome of the proposal to increase transparency would actually result in a misrepresentation of the Company's true tax position.

Recommendations for an Amended Proposal

The concerns identified by ALICA and our recommendations are set out below:

a) The use of total profit as the first 'disclosed' figure rather than total income. It will be more useful for transparency purposes if the total profit and the corresponding taxable income figures are used, so that one may be compared with the other, highlighting where accounting profits and the taxable income are very different (for instance, where capital gains are also being included).

b) Limiting distortions arising from the imputation system (i.e. the gross up for imputation credits in determining taxable income and/or reduced tax payable due to income tax offsets). ALICA recommends the following options be considered to minimise imputation distortions:

i) Franked dividends received directly by companies, for which the company is entitled to a tax offset, plus the corresponding imputation credits should be excluded from the taxable income disclosed by the ATO. This information could be determined from the Company Tax Return based on the franking credit disclosure made by companies in the Company Income Tax Return. This will ensure that the reported figures for 'taxable income' that are published do not include income upon which tax has already been paid by other companies for which a tax offset is available.

ii) Total net profit or loss should also explicitly exclude franked dividend income (so that there is consistency in the treatment of dividend income).

Should ALICA's recommendations at i) and ii) above be adopted (ALICA's preferred option), the disclosures required by the Company would instead be as follows:

Table 2

Name	ABN	Total Profit[2]	Taxable Income[3]	Income Tax[4]
The Company	XX	$9,000,000	$9,000,000	$2,700,000

The above disclosures at Table 2 would therefore reduce the imputation distortions highlighted above and produce a clearer and more transparent picture of the Company's own taxable activities.

iii) Alternatively, the figure published with respect to an entity's income tax liability could be the tax on taxable income excluding any income tax offsets, rather than the tax payable figure. However, this would still mean that the income tax figure shown would include amounts that were not payable by the company as those amounts are payable by another company.

Should ALICA's recommendations at iii) above be adopted (ALICA's less preferred option), the disclosures required by the Company would instead be as follows:

Table 3

Name	ABN	Total Profit	Taxable Income	Income Tax[5]
The Company	XX	$209,000,000	$295,000,000	$88,700,000

Although adopting an approach as set out in Table 3 should provide a more transparent picture of the ALICA member company's income tax profile than the current proposal, as noted above it does still confuse the amount of tax payable by the Company with that already paid by other companies.

c) The published information should explicitly note that the information given is in summary form only, and that the financial statements and other published information produced by the relevant company should be studied in conjunction with the disclosures made by the company.

2 Amount disclosed is net of franked dividend income
3 Amount disclosed is net of franked dividend income and the associated gross up
4 Tax Payable has been based on item T5 of the Calculation Statement of 2012 Company Tax Return Form
5 Tax Payable has been based on item T1 of the Calculation Statement of 2012 Company Tax Return Form

I would be more than happy to discuss any of the above in more detail at your convenience.

Yours faithfully,

A.J. Hancock
Secretary