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## ATO brews franking confusion

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A long overdue reform of the Corporations Law that would have made it easier for Australian companies to pay out billions of dollars in franked dividends looks to have come a cropper at the door of the Australian Taxation Office (ATO).

In a bizarre situation that points to a lack of basic communication between two of the country's largest and most powerful bureaucracies, amendments to the Corporations Law promoted by Treasury appear to be in conflict with the legal interpretation of the ATO.

What makes it even more bizarre is that the ATO issued its interpretation of how the amendments would work in late June, almost a year after the Corporations Law was changed.

The end result is that listed companies are heading into this reporting season in total confusion about what component of dividends can be franked and what component must be treated as a capital return.

It would be fair to say that the market in Australian listed companies capable of paying dividends is not informed. To get an idea of the confusion, one need only read the financial statements lodged last week by Alesco, the industrial marketing and distribution company.

After declaring a final dividend and a special dividend, Alesco said that "as a consequence of amendments to the Corporations Act 2001 in 2010 impacting on the payment and franking of dividends, the commissioner of Taxation has informally expressed a preliminary view in an ATO Draft Fact Sheet dated June 21, 2011, that where a company's net assets are less than its share capital and the company debits a dividend to an account such as accumulated losses, a dividend will be sourced indirectly from share capital and will be unfrankable".

That is the sort of gobbledygook that was meant to be removed by the amendments to the Corporations Law. But it is the natural outcome of the confusion created by the ATO.

Alesco says it considers the dividends it has declared for the year ending May can be franked because they are paid out of current-period profits. But it has sought a ruling because the ATO Draft Fact Sheet does not specifically address the circumstances where a company is paying a dividend from current-period profits.

It is hard to believe that this confusion is occurring, considering the reform process began in 2008 and the amendments to the Corporations Law to clarify dividend payments were made only after extensive industry consultation.

To go back to square one. Until the Corporations Law was amended last year, dividends could be paid only out of profits. But this was vague and the legal precedents on the issue were outdated, complex and not in line with current accounting principles.

That made it difficult for directors to understand the legal requirements when paying dividends. Changes to accounting standards meant that movements in the fair value of assets were affecting profits and, in some cases, stopping companies with sufficient cash or retained earnings to pay dividends.

The Corporations Law needed amending because it was based on an anachronistic capital maintenance concept.

The amended section 254T of the Corporations Law says: "A company must not pay a dividend unless: (a) the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend; and (b) the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and (c) the payment of the dividend does not materially prejudice the company's ability to pay its creditors."

The intention was to ensure that companies had the ability to distribute dividends if they were able to do so without causing detriment to ongoing operations. But it would appear that the accompanying amendment to Section 44 (1A) of the Income Tax Assessment Act did not go far enough or created confusion.

It is clear from industry analysis of the ATO Draft Fact Sheet issued in June that the ability to frank dividends

as a consequence of the change to the Corporations Act has remained unchanged.

There is obviously a disconnect between what was intended to happen from the Corporations Law amendments and what can be done under the new amendments to the Tax Law, according to the tax counsel at the Institute of Chartered Accountants, Yasser El-Ansary.

He says Treasury made clear during the industry consultation process that it wanted to make it easier for Australian companies to distribute franking credits. The reasons are obvious. Franking credits underpin the formation of patient capital.

Dividends provide a backstop during times of crisis when capital values fall. Finally, franked dividends are the foundation of retirement income planning for many Australians.

It has been estimated that there are about \$100 billion in franking credits stockpiled in Australian balance sheets.

The lesson from this debacle is that there should be greater co-ordination between Treasury and the ATO when making fundamental changes to the law relating to taxable income. The problems have been brought to the attention of the responsible minister, Bill Shorten.

In the meantime, confusion will remain. Alesco's request for a ruling from the ATO on its dividend payments has at least started the wheels turning on ending confusion. The company has been told by the ATO that it will endeavour to provide the ruling before September, when the dividends are due to be paid.

However, that leaves open the uncertainty about whether the original intention of the government and the Treasury will be realised.

Shorten was last night being a bit cagey about where he stood on the issue. A spokesman for Shorten said: "This is a draft ruling by the ATO and is subject to revision following the consultation period. The government encourages interested parties to make a submission to the ATO and make sure their views on this issue are known. If stakeholders consider the ATO's draft ruling does not align with the policy intent of the measure, then of course they should point this out."



Those who have followed the telecommunications industry for years will not be surprised that the latest batch of concessions from Telstra, designed to make the price of access to its copper network more transparent, have been greeted with disdain by its largest competitor, Singapore Telecommunications subsidiary Optus.

While Telstra is trumpeting a number of breakthroughs in its level of transparency in its structural separation undertaking, Optus says it is largely a repackage of the current arrangements with a few additional immaterial governance arrangements. The level of distrust between the companies is so great that on the same day that Telstra said it was committed to equivalence of pricing, Optus said it was still possible the incumbent would not provide wholesale services to its retail division on the same terms as its wholesale customers. Chanticleer believes Telstra is making concessions that will improve the competitive landscape. It will be more accountable and it will be more open about the costs involved in running its network.

It would seem Optus is stuck in the trench that it dug several years ago when Paul Fletcher was head of regulatory affairs, and before he entered Parliament as the Liberal member for Bradfield.

That is not to say Telstra has not used the loopholes in the regulatory system to its advantage, including delaying tactics and launching unnecessary legal challenges.

But the Optus position has its fair share of humbug. It opposes reform to mobile termination rates and it probably has the worst record in Australia for lack of truth in advertising.

Concessions made by Telstra in relation to wholesale broadband reference prices will be a cost to Telstra shareholders, but Optus was not impressed.

The continuing debate about whether black is white in telco land will have to be resolved by the Australian Competition and Consumer Commission under its new chairman, Rod Sims.

But that is what the ACCC is for. It will be the final arbiter of whether Telstra is trying to pull the wool over our eyes for regulatory arrangements that will be in place for about 10 years.



The move in the Macarthur Coal share price to within a whisker of \$16 following its rejection of the formal offer from Peabody Energy Corporation and ArcelorMittal says the market thinks the company will change hands at that price.

The company's board obviously believes someone else is out there who will have a crack despite the fact no other competing offer has emerged since the joint venture bidders turned up.

Directors have dollars in their eyes from 2008 when investors, including ArcelorMittal, bought shares at \$20 each.

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The Australian Financial Review

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