PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers Deferred Company Tax Coalition

SUBMISSION ON

A PLATFORM FOR CONSULTATION

ISSUED BY REVIEW OF BUSINESS TAXATION COMMITTEE

April 1999

CONTENTS

1	**EXECUTIVE SUMMARY**	
2	**INTRODUCTION**	6
3	**WHY IS A REDESIGN OF THE IMPUTATION SYSTEM BEING CONSIDERED?**	8
4	**WHAT ARE THE OBJECTIVES OF A REDESIGNED IMPUTATION SYSTEM?**	11
5	**THE PREFERRED OPTION – RESIDENT DIVIDEND WITHHOLDING TAX**	2
	5.1 The Advantages of RDWT	12
	5.2 The Government	13
	5.3 Resident Shareholders	13
	5.4 Non Resident Shareholders	14
	5.5 Dividend Payers	15
	5.6 The Disadvantages of RDWT	16
	5.7 Unfranked Dividends flowing through Corporate Groups	17
	5.8 Other Recommendations for RDWT	18
6	**THE DEFERRED COMPANY TAX PROPOSAL**	19
	6.1 What is Tax Preferred Income	20
	6.2 Reduced Dividend Payouts – Timing Differences	22
	6.3 Reduced Dividend Payouts – Foreign Income Distributions	24
	6.4 Reduction in share price for Australian listed companies	25
	6.5 Reductions in returns to non resident non portfolio investors	26
	6.6 Impact on new Productive Investment	27
	6.7 DCT exemption for distributions of foreign income	27
	6.8 Should companies obtain a credit for DCT paid?	28
	6.9 How to address Double Taxation?	29
	6.10 Transitional Issues/Tax Losses	31
	6.11 Entity Tax Regime and Branches	31
	6.12 Concluding Comments on DCT	32
7	**TAXATION OF UNFRANKED INTER ENTITY DISTRIBUTIONS**	34
8	**NON RESIDENT INVESTOR TAX CREDIT**	35
9	**EXAMPLE OF IMPACT OF DCT ON A HYPOTHETICAL COMPANY**	37
	9.1 Assumptions	37
	9.2 Summary of Effective Tax Rates	37
	9.3 Example	38

1 EXECUTIVE SUMMARY

1 The PricewaterhouseCoopers Deferred Company Tax Coalition voices strong opposition to the full franking of dividend distributions through the proposed Deferred Company Tax ("DCT") regime. We do not believe that it is in Australia's economic best interests for the DCT to be introduced.

2 We submit that, in the context of the Review of Business Taxation Committee's ("RBT") final report, a Resident Dividend Withholding Tax ("RDWT") is a compromise that we can accept, on the basis that it does not give rise to the adverse consequences of a DCT.

3 In respect of a DCT, it is considered that:

- DCT would reduce the distributions of Australian listed companies;
- these reductions would raise the cost of capital to these companies and have a negative impact upon the share price of these companies;
- this would make Australian companies susceptible to take-over by foreign companies able to access a lower cost of capital
- new productive investment in Australia would fall as mobile global investment capital was directed to jurisdictions offering greater returns;
- the proposals are inconsistent with industry policy, in particular, the benefit of specific targeted industry concessions is removed; and;
- some companies will have no option other than to cease (or at least reduce) paying dividends, forcing these companies to become growth stocks rather than being income stocks as they currently are.

4 Accordingly, we see the RDWT as the only viable option proposed by the RBT, for the following reasons:

- the RDWT maintains the Australian tax liabilities of Australian resident corporates at their current levels;
- the RDWT adds integrity by collecting Australian tax on unfranked dividends at the time those dividends are paid to shareholders; and

- RDWT carries none of the commercial disadvantages inherent in the alternative DCT proposal.

5 If a DCT is to be introduced, Australia can not afford to accept it in the form that it has currently been recommended. Our overseas experience indicates that a DCT will only be a workable solution if:

- a credit for DCT payments attributable to timing differences is made available against future income tax payments;
- there is a carve out from the DCT regime for the distribution of tax preferred income arising from specifically provided tax incentives;
- there is a carve out from the DCT regime for the distribution of foreign source income to all shareholders, not just non resident shareholders;
- there are adequate transitional provisions implemented to address issues arising in the period of changeover and in particular, the treatment of carried forward tax losses and existing balances of unfranked distributable reserves; and
- the application of DCT to entities other than companies will have to be defined, especially branches which face unique issues, such as how to determine the amount of a distribution, etc.

6 The PricewaterhouseCoopers Deferred Company Tax Coalition endorses the proposal for the introduction of the Non Resident Investor Tax Credit ("NRITC") in conjunction with RDWT.

7 The PricewaterhouseCoopers Deferred Company Tax Coalition notes the proposals to extend the foreign dividend account conduit income relief to foreign sourced income. Whichever method of 'full franking' is adopted, the PricewaterhouseCoopers Deferred Company Tax Coalition strongly supports any proposal to extend this relief to all distributions of foreign sourced income.

8 The PricewaterhouseCoopers Deferred Company Tax Coalition also strongly supports any proposal to enable the full streaming of foreign sourced income to non resident shareholders. Such treatment is vital to enable our major companies to attract capital to fund further expansion into the global business markets.

2 INTRODUCTION

9 The Deferred Company Tax Coalition welcomes the opportunity afforded to it to respond to the RBT's second discussion paper, *A Platform for Consultation*. The Deferred Company Tax Coalition understands the significance of the task given to the RBT and trusts that our submission will be of assistance to the RBT in the preparation of its final report to the Government.

10 The RBT has called for consultations and submissions to assist it in relation to two matters:

- "First, the Review seeks advice on reform options that will best achieve an internationally competitive tax system minimising distortions of commercial decision making.
- "Second, where submissions ask the Review to evaluate proposals for deviations from a neutral tax system to pursue non-tax objectives, the Review seeks advice on the design of effectively targeted concessions."

11 It is in light of these requests that this submission has been prepared. This submission concentrates on assisting the RBT in respect of the first matter, that of ensuring that the RBT's recommendations achieve an internationally competitive tax system.

12 The Deferred Company Tax Coalition is in a unique position to perform this task. It is not an industry body nor is it a specific special interest group. Rather it is a collection of over 40 companies, including some of the largest, most successful and well respected Australian and International companies. No one industry dominates the Deferred Company Tax Coalition, rather its members participate in industries ranging from banking and finance to mining, agriculture to insurance, retail to manufacturing.

13 Our submission is predominately concerned with the discussion set out in the following two Chapters of *A Platform for Consultation*:

- Chapter 15: A Fairer and More Consistent Treatment of Entity Distributions; and

- Chapter 17: How a Redesigned Imputation System Would Apply to Entities.

14 The members of the Deferred Company Tax Coalition generally do not agree with the overriding rationale that detailed reform of the dividend imputation system is required. On this basis, we do not believe that there is an absolute necessity that any of the options proposed in *A Platform for Consultation* should be implemented. Notwithstanding this, we acknowledge that such a statement is outside the bounds of the RBT’s terms of reference. For this reason we have limited our comments in this submission to matters raised explicitly or implicitly in *A Platform for Consultation*.

3 WHY IS A REDESIGN OF THE IMPUTATION SYSTEM BEING CONSIDERED?

15 In preparing for its review, the RBT formulated four basic benchmarks against which the business tax reforms could be assessed. One of these is the entity taxation benchmark. As part of that benchmark, the RBT set a policy design principle of a single layer of taxation. *A Platform for Consultation* contends that the existing dividend imputation system is not operating in the desired manner and in fact does not achieve this design principle. The four basic areas where *A Platform for Consultation* considers that the existing system is inadequate are:

(a) *The existing company imputation system is complex.*

Whilst we acknowledge that the current system is not simple, we note that it is currently accepted and implemented by all of corporate Australia. The various proposals put forward by the RBT involve different levels of complexity within themselves. For example, whilst the taxation of unfranked intercorporate dividends is simple, we would question whether there would be any significant reduction in complexity if the options of DCT, combined with the NRITC regime, and foreign income account carve outs on distributions to non residents were to be adopted. The critical point at issue here is whether integrity should be sacrificed merely for simplicity.

One of the perceived complexities is the fact that dividends may be franked, unfranked or partially franked. We note that the design and operation of an imputation system is one where a shareholder receives full credit for any corporate tax paid by the entity of which the shareholder is a member. This is the fundamental principle referred to above, that of a single layer of taxation.

A full imputation system does not, of itself, require the full franking of distributions. Rather, the full imputation system sees credits for company tax paid being passed to shareholders in full in order to avoid double taxation on the income derived by the company. It is a function of an imputation system that operates to pass a credit for tax paid by a company to its shareholders that some dividends will necessarily be franked

and others will be unfranked. To do otherwise may lead to double taxation.

(b) *The existing system previously contained an incentive for companies to stream franking credits.*

It is accepted that the current system previously provided companies with an incentive to stream franking credits to those parties whom benefit the most from the franking. These incentives have now been addressed by the comprehensive legislation dealing with dividend streaming, exempting credits and trading in franking credits. This legislation whilst outwardly complex has the simple result – the ability of companies to stream dividends is virtually non existent.

(c) *Under the existing imputation system low marginal rate shareholders are disadvantaged.*

We acknowledge that low marginal rate shareholders are disadvantaged under the current imputation system. However, this disadvantage arises purely due to the fact that the system does not currently allow excess imputation credits to be refunded in cash to the shareholders. In itself, a system that operates a full franking of corporate distributions will not change this consequence for low marginal rate shareholders. The consequences for low marginal rate shareholders can be addressed by amending the current provisions to allow for a cash payment of the excess imputation credits as has been proposed by the Government in *A New Tax System*, and by the RBT in *A Platform for Consultation.* To achieve this cash payment of excess imputation credits, it is not necessarily a requirement that all distributions are fully franked.

(d) *The section 46 intercorporate dividend rebate creates unintended loopholes.*

We acknowledge that the section 46 rebate can create consequences where untaxed income can be distributed between corporate entities, thus preserving the untaxed nature of that income until it is distributed to a taxable shareholder. However, we suggest that with the existing provisions whereby the section 46 rebate is denied to a corporate entity receiving an unfranked dividend, except for distributions received within a group

relationship or by a public company (or its wholly owned subsidiary including an Australian subsidiary of a non-resident public company), the leakage to the Revenue is minimal. In any event, we note that the section 46 intercorporate dividend rebate system is unique to Australia and is an inherently complex method of dealing with the taxation of intercorporate dividends. In this regard, we note that in many jurisdictions and particularly those of our most significant trading partners, intercorporate dividends are exempt from tax.

16 In conclusion, we would comment that the stated inadequacies of the current imputation system are not necessarily matters which can be resolved merely through the operation of a full franking system.

4 WHAT ARE THE OBJECTIVES OF A REDESIGNED IMPUTATION SYSTEM?

17 In *A New Tax System*, the government proposed a redesigned imputation system, with the following two fundamental changes:

- full franking of all distributions; and
- making excess imputation credits refundable.

18 We applaud the RBT for recognising that full franking is only a means and not an end. *A Platform for Consultation* therefore proceeds on the basis of what is required is to improve the integrity of the imputation system and that this does not necessarily require full franking.

19 In fact, *A Platform for Consultation* acknowledges in paragraph 15.22 that achieving full franking via the DCT proposed in *A New Tax System* has some disadvantages. It proceeds to then question whether the integrity benefits of full franking can be achieved in other ways without the disadvantages of the DCT approach.

20 This is the basis of our submission. However, we are disappointed that whilst recognising the inherent problems with a DCT, *A Platform for Consultation* does not go far enough to highlight these problems.

21 One of the main thrusts of our submission is to ensure that the RBT is sufficiently informed as to the disadvantages of the DCT option and the significant damage that the proposal will cause for a large proportion of Australian companies.

22 The balance of our submission therefore expands upon the discussion of each of the options contained in *A Platform for Consultation*. We believe that this will assist the RBT in finalising its report to the Government and ensure that the RBT is aware of all of the impacts of each of its proposals.

5 THE PREFERRED OPTION - RESIDENT DIVIDEND WITHHOLDING TAX

23 The RDWT proposal contemplates a withholding tax levied at the entity tax rate on unfranked distributions paid by Australian entities to Australian resident investors. Unfranked distributions paid to non resident investors would be subject to the existing non resident dividend withholding tax ("DWT"), generally levied at 15% for residents of treaty territories. The RDWT would not apply in respect of distributions made within a consolidated tax group.

24 We consider that a RDWT achieves the Government's objective of collecting tax at the point of payment on unfranked distributions paid to resident shareholders. This has not only been indicated by us in our previous discussions with members of the RBT, but we are aware that it has been affirmed by many other interested parties and commentators.

5.1 The Advantages of RDWT

25 The RBT considers that the advantages of RDWT include:

(a) unfranked dividends to non residents would continue to be subject to DWT only;

(b) after tax profits of dividend paying entities would not be adversely affected; and

(c) collection of RDWT should be a relatively simple process as the existing DWT mechanisms and provisions in the legislation could be amended and utilised for this purpose.

26 We agree with these findings. RDWT, as a solution to the objectives for the reform of the imputation system, achieves the desired objectives with minimal complication and no new administrative mechanisms (subject to our comments below) need to be created to deal with the RDWT – the mechanisms are in place and operating efficiently.

27 We suggest that the attractiveness of using RDWT as the working model can be summarised by considering the benefits of the RDWT model to the various interested parties.

5.2 The Government

28 The RDWT working model achieves the substantial objectives set out for the reform of the imputation system in order to protect the Australian Revenue and the Australian economy. It achieves:

(a) an acceleration in the collection point of tax on unfranked dividends paid by resident entities to resident shareholders;

(b) the leakage of income tax due to undeclared dividend income will be substantially reduced;

(c) the stated objective of a form of "repayable imputation credits" for resident individuals and superannuation funds is achieved, albeit in the form of a refund for the resident dividend withholding tax credit (or underlying franking credits);

(d) many of the adverse impacts on the Australian economy which may arise under alternative scenarios would be avoided. These adverse impacts are discussed further below;

(e) further, there would no longer be a requirement for any double tax treaty to be renegotiated on the point of the rate or type of tax that the Australian Revenue was entitled to levy.

5.3 Resident Shareholders

29 The RDWT working model would give rise to minimal change for resident individuals, superannuation funds, trusts and private companies, other than:

(a) The taxing point on unfranked dividends would be accelerated in comparison to the current regime, thus causing a minor cash flow cost;

(b) Excess withholding credits would still be repayable to individuals and superannuation funds when these credits exceed the tax payable;

(c) Private companies would not be able to claim any repayment. However, the unfranked dividend would be subject to a full intercorporate dividend rebate, having been "franked" by the domestic withholding tax; and

(d) An exemption system could apply where companies would not ordinarily pay tax on dividends. Such companies may be in a tax loss position or be a public company or a subsidiary of a public company. The exemption system would be administered by the Australian Taxation Office, the taxpayer would apply and be responsible for notifying the dividend payer. An exemption system would be simple to administer.

30 The Deferred Company Tax Coalition submits that dividends paid to public company shareholders and their wholly owned resident subsidiaries should not be subject to the RDWT provisions. We submit that such companies should receive the dividend gross and continue to receive the benefit of the full intercorporate dividend rebate. On the basis that there is no discernible tax leakage on unfranked dividends paid to public companies and their resident wholly owned subsidiaries, there are good arguments that they should not be the subject of the withholding provisions. Similarly, dividends paid to wholly owned resident subsidiaries of non-resident public companies should not be the subject of the RDWT provisions. These companies will pay DWT on their dividends to non-resident shareholders.

31 Many public companies and their wholly owned resident subsidiaries use unfranked dividend income as a source of funding for further investment, including non-residents with operations in Australia. Reducing this source of income through a withholding could reduce the level of investment in the economy. Further, many public companies and their wholly owned resident subsidiaries make significant investments in incorporated joint ventures, lending their expertise to productive ventures in many areas. Subjecting the returns from these ventures to RDWT may see a decrease in the number of such ventures.

5.4 Non Resident Shareholders

32 Non-resident shareholders hold a significant, but generally passive, influence over the Australian economy. However, any significant amendment to the returns achieved by these shareholders could see significant outflows of investment capital from Australia into other more productive areas.

33 Non resident portfolio shareholders hold significant interests in listed Australian companies. The influence of the portfolio shareholders is a significant determining factor in the cost of capital to Australian listed companies, and their relative competitive position in the global capital

markets. The investment capital of these shareholders is the most portable of any equity capital invested in Australia. The withdrawal of this investment capital would be likely to raise the overall cost of capital to Australian listed companies, and the economy generally.

34 Non resident non portfolio shareholders on the other hand, invest significant sums of monies into their Australian subsidiaries for strategic, productive investment. Their investment capital is not as portable as that of the portfolio investor. However, any change in their return from Australia will influence their decisions on the level of future investment in Australia, and may ultimately lead to the withdrawal of this long term productive capital.

35 The RDWT working model will protect the Australian economy by reinforcing the position of non resident shareholders. The position of these shareholders would be fundamentally unchanged from that which currently exists. Unfranked dividends would continue to be subject to a DWT of 30% reduced to 15% by most double tax treaties. The tax would remain a tax on the shareholder. Accordingly, in those territories operating a foreign tax credit system, the tax should remain capable of full double tax relief. This would maintain the propriety of the Australian Tax system with foreign investors and avoid divergence with other major tax jurisdictions.

5.5 Dividend Payers

36 The RDWT working model would see Australian companies maintaining their current levels of gross dividend payments. The dividend yield and reported profits of these companies would not be affected, nor their cash flows disadvantaged, unlike under the DCT proposal.

37 Non-resident shareholders resident in treaty jurisdictions would see no change in their dividend yield or the nature of taxes on their dividends. This would remove the likely increase in the cost of capital that would be experienced by Australian entities, and the Australian economy generally, under the DCT proposal.

38 Companies will be required to maintain a listing of those resident shareholders which qualify as public companies, if such companies are to be given an exemption from the RDWT provisions. This is likely to cause a small increase in the level of administration for these companies. However, it is suggested that this cost would be

insignificant in comparison to the additional costs that may arise under the DCT proposal. As suggested above, this may be simply administered by a system of exemption notice by application to the Australian Taxation Office and the responsibility of the taxpayers to provide to the dividend payer.

39 The critical point, and it is critical, is that the RDWT achieves the acceleration of the collection point, without giving rise to the two major problems of DCT, being an increase in the cost of capital of many Australian companies and the significant reduction in returns to non resident investors. This is because the RDWT is a tax on the recipient shareholder and not an additional tax on the dividend payer, ie. the company. DCT represents a fundamental change to the tax system. We see no reason for such a fundamental change to occur.

5.6 The Disadvantages of RDWT

40 The RBT notes that the disadvantages of RDWT include:

(a) the incentive for dividend streaming would remain and hence the existing complex anti avoidance provisions to deal with this matter would need to be continued;

(b) it would be necessary for companies to continue to identify the franked and unfranked component of dividend payments;

(c) complexity will arise from the identification of the unfranked and franked dividend components, accordingly giving rise to complexity from the identification of dividends franked with mainstream corporate income tax payments and those components that are franked with RDWT.

41 Whilst we acknowledge that some degree of administrative complexity will arise for companies paying dividends, the members of the Deferred Company Tax Coalition, who are representative of the broad range of entities and businesses operating in Australia, indicate that they are prepared to accept the increased administrative effort required in order to avoid the adverse consequences of DCT.

42 We submit that the incentive for companies to stream (and trade in) franking credits to shareholders who can obtain the most benefit from them will continue if this model of the RDWT is adopted. The exempting credit rules contained in *Tax Laws Amendment Act (No 4)*

1998 are effective in removing the majority of the source of the imputation credits that were previously traded. In addition, following the introduction of the comprehensive anti dividend streaming provisions, the remaining loss to the Revenue from franking credit streaming is considered not to be significant enough to be of concern.

5.7 Unfranked Dividends flowing through Corporate Groups

43 We note the findings of the RBT in relation to the need to refund RDWT and collect DWT on payments to non residents.

44 We understand that the aim of this proposal is to achieve parity with the situation where a non resident investor is receiving the unfranked dividend directly. In that situation, the non resident would be subject to DWT of 15%, and the DWT would be withhold by the entity paying the unfranked dividend.

45 This can be contrasted with the situation where the unfranked dividend was being paid through another corporate group (other than a wholly owned group headed by a public company, albeit resident or non-resident). In this situation we note that the non resident would be subject to an underlying RDWT liability of 36%, meaning that the dividend would be paid out free of any further DWT cost. We make this comment subject to the comments on the NRITC regime below.

46 Our suggestion is that for distributions through corporate chains, the RDWT be regarded as the impost to fully frank outgoing dividends such that no further RDWT would be required to be withheld on the on distribution of these dividends. As recommended by the RBT, a credit could then ultimately be available to the non-resident to ensure that they are not disadvantaged.

47 Most non residents will be receiving unfranked distributions either from a portfolio investment in an Australian listed company, or from a non portfolio investment in an Australian subsidiary. In the case of a dividend from a public company, RDWT should not have been withheld on any dividends paid into the group and so no issue arises. Where the group is not a public company group, RDWT may have been deducted and a mechanism will need to exist to refund this additional cost.

48 The extent of further investment by non residents where unfranked dividends would be received indirectly is likely to be through some

form of collective investment vehicle. The RBT proposes in Chapter 30 that collective investment vehicles favoured by non residents may be treated as flow through vehicles, such that any unfranked distributions received by those vehicles would be regarded as being received directly by the non resident. In this case, DWT could be collected through existing mechanisms whereby the vehicle would collect and remit DWT as part of the liability of the non resident.

49 The exemption for dividends paid to public companies from the RDWT working model is therefore critical to remove this additional impost on the non resident shareholders for unfranked dividends received, and paid on by public companies and their resident subsidiaries. Similarly, dividends paid within a corporate group should also be free from RDWT, thereby avoiding this problem.

5.8 Other Recommendations For RDWT

50 We would also recommend that a RDWT should be structured so as to include the following:

(a) the NRITC regime;
(b) a carve-out for foreign income that is subject to tax, including withholding taxes (refer our detailed discussion below in respect of DCT);
(c) a carve-out for tax concessions such as Research & Development (refer DCT below); and
(d) intra-group dividends within a consolidated group should also be excluded.

6 DEFERRED COMPANY TAX PROPOSAL

51 The Deferred Company Tax Coalition is strongly opposed to the introduction of a DCT regime to achieve the stated objectives for the reform of the imputation system.

52 The Deferred Company Tax Coalition consider that the commercial consequences of such a regime would cause significant adverse consequences for Australian resident companies, and the Australian economy in general.

53 The Deferred Company Tax Coalition consider that the stated objectives for reform of the imputation system can be achieved through alternative models that will not give rise to the adverse consequences that are likely to arise from the introduction of a DCT regime.

54 DCT is a proposal that advocates that the distribution of tax preferred profits would be subject to tax at the entity level such that all distributions would be fully franked.

55 Under the proposal for DCT, *A Platform for Consultation* notes that:

(a) company tax paid would then be creditable under the imputation system to resident individual shareholders and superannuation funds;

(b) DCT would apply to all distributions of tax preferred income from one entity to another, with the exception of distributions within consolidated groups; and

(c) the franking account system could be used to determine those situations where tax preferred income was being distributed and where DCT was required to be levied.

56 We acknowledge that, viewed at a purely domestic level, DCT may be capable of providing an imputation system with the required level of integrity and neutrality. However, the Australian economy and Australian business does not operate independently of the global economy and global capital markets. This interaction between the Australian economy and these markets means that Australian companies derive foreign source income, Australian companies have non resident shareholders, and Australian businesses and the

Government source equity and debt funding from the global capital markets. The DCT regime proposed is likely to cause a number of unintended consequences which will adversely affect many Australian companies, and the Australian economy generally, as a result of the influence of these international markets on the Australian economy.

57 The potential significant adverse implications of DCT, and the consequences thereof are likely to be:

(a) reduced dividend payouts by Australian companies;
(b) a reduction in the share price for Australian listed companies paying unfranked dividends;
(c) significant reductions in the returns from unfranked dividends to non resident shareholders;
(d) a reduction in the level of new productive investment by non resident non portfolio shareholders;
(e) a withdrawal of capital from the Australian market by non resident portfolio shareholders;
(f) Australian companies, and the Australian economy generally becoming less competitive in the global capital markets;
(g) an increase in the cost of equity and debt capital for Australian companies and the Australian economy generally.

58 It is difficult to quantify the impact of these points given their nature and the short timeframe in which we have to make our submission. However, this absence of quantification should not be used as a means of discounting the issues. These are very significant issues that must be addressed prior to the finalisation of the RBT's recommendations. A detailed example showing the real impact on the effective tax rate of shareholders is set out in Section 9.

6.1 What is Tax Preferred Income?

59 The objective of DCT, being the requirement to fully frank dividends, is understandable and is not at issue. However, we suggest that the RBT have failed to recognise that unfranked dividends are paid for a variety of reasons, the majority of which have little to do with income or profits that have received some form of concessional tax treatment.

60 Australian companies pay unfranked dividends when the entirety of the underlying accounting profits have not been subject to Australian tax. Australian tax may not have been paid due to:

(a) timing differences;
(b) income which has been subject to a specifically designated tax concession;
(c) foreign source profits previously subject to foreign tax; or
(d) past tax losses.

61 Unfranked dividends can arise due to timing differences. These differences occur due to differences between the timing of the recognition of income, expenses and profits for tax and accounting purposes. The recognition of income and profits for accounting purposes is governed by accounting standards and the Corporations Law. We question why this should be regarded as tax preferred income, giving a suggestion that there is some avoidance or overall or permanent advantage, when the tax regime is a function of the commercial regime, and not vice versa.

62 Permanent differences which arise as a result of specific taxation concessions can give rise to tax preferred income. However, these tax concessions have been placed into the tax legislation for a specific reason. Concessions such as the research and development incentive, investment allowances, and the offshore banking unit income concession have been specifically designed to provide incentives to encourage certain patterns of behaviour.

63 The RBT is clearly aware of this issue, though it appears to have chosen not to address it. In the overview in *A Platform for Consultation,* the RBT suggests that it is aware that the Government is currently formulating a strategy for developing Australia as a regional financial centre and states that it will be important for its recommendations to have regards to this objective. Such regard does not appear to have been paid, given that DCT is likely to have an adverse impact on any such concessions.

64 If this objective or the objective of any other concession was to enable companies to earn such income or claim such deductions without being subject to mainstream company income tax obligations, then replacing that concession with tax on the those profits by another name, DCT, is clearly bad policy.

65 Another significant reason for unfranked dividends is foreign source dividend income which is not generally subject to Australian tax. Once again this is not tax preferred income, but is income on which tax has been paid outside of Australia. For policy reasons this income is not

subject to tax in the hands of the corporate shareholder when it is remitted to Australia in the form of dividends.

6.2 Reduced Dividend Payouts – Timing Differences

66 The DCT regime would cause Australian companies to have lower cash dividend payouts when unfranked dividends were required to be paid net of a non creditable DCT cost. The RBT consider that DCT in these situations is merely an acceleration of part of what is currently the income tax liability of the shareholder into a liability of the company.

67 We contend that the reduction in the payout by companies will be greater than the mere DCT cost in circumstances where the unfranked dividend has arisen due to timing differences.

68 The RBT does note that potential double taxation may arise due to tax timing differences. We are in compete agreement with this assertion. However, we have a significant concern that the RBT has chosen to assume this problem away on the basis that it will not be a significant cost. We believe that it is a fundamental flaw in any analysis of the DCT not to consider the full impact of such double taxation upon a company. We consider that any process attempting to seek greater integrity in the tax system cannot be successful without consideration of those areas where double taxation is likely to arise.

69 Further, in dismissing the issue of double taxation, the RBT has not fully addressed the impact of DCT on the distributable profits of companies. In particular, the numerical examples set out in Table 15.2 of *Platform for Consultation* fail to properly take into account the impact of tax effect accounting on the distributable profits of the company.

70 Contrary to the example given in Table 15.2, timing differences do not give rise to additional income being available for distribution to shareholders. At the time of determining distributable profits, a deferred tax liability will be provided in respect of income recognised in the accounts which is not subject to tax until a future period. This is because the income tax expense recorded in the accounts is based on accounting profits adjusted for permanent differences only, not timing differences. Therefore, the income tax expense for any year will take into account both the tax payable for that year and any tax payable in future years in respect of the current years accounting income (i.e. which will be reflected in the deferred tax liability).

71 This will leave the company's distributable profits the same as if the income was actually subject to income tax in the year it is recognised for accounting purposes. Any contention that income which is recognised for accounting purposes in advance of tax recognition is tax preferred, or gives rise to greater distributable profits than would be the case under a pure tax accounting system is incorrect.

72 However, the distribution of these underlying "tax preferred" profits, will give rise to a further payment of tax, in the form of DCT. Accordingly, the underlying rate of tax on the profits of the company will be the sum of the full company tax rate, plus the DCT payable in respect of the amounts distributed by the company to its shareholders.

73 This problem is demonstrated in the table below, which considers a company with an accounting profit of $100 and a taxable income of $50, the difference between the two being the result of a timing difference, such as accelerated tax depreciation. This is the same fact pattern as used in Table 15.2.

	Year 1	**Year 2**
Income	150	150
Accounting Depreciation	(50)	(50)
Accounting Profit	100	100
Tax Adjustments:		
Accounting Depreciation	50	50
Tax Depreciation	(100)	0
Taxable Income	50	150
Accounting Profit	100	100
less		
Tax Expense		
Provision for Income Tax	(18)	(36)
Provision for Deferred Tax	(18)	
Deferred Company Tax	(12)	
Available Distribution	52	64
Effective rate of tax on profits	48%	36%

74 As can be seen, the distributable profits in the first year are $52, being the accounting profit reduced by the sum of the tax payable in respect of the current year taxable profits, the tax payable in respect of tax deferred profits, and the deferred company tax. Notwithstanding that over the 2 years in question, the taxable profits of the company equal the accounting profits, the impact of DCT is a reduction in the distributable profits of the company and hence the return to shareholders. Refer also to the more detailed example set out in Section 9.

6.3 Reduced Dividend Payouts – Foreign Income Distributions

75 The proposed DCT regime will result in double taxation of the foreign source profits of all Australian companies with significant offshore operations. At a time when Government agencies such as AusTrade are encouraging companies to expand into new markets, the DCT proposals will ensure a second level of tax on the foreign sourced profits of these companies.

76 The RBT notes that a disadvantage of DCT is that the reported after tax profits of entities would be reduced for those entities that are required to pay DCT on their unfranked distributions. The Review considers that the markets and shareholders would need to appreciate the impact of the change in the imputation system on those listed companies deriving significant tax preferred income. It is submitted that such a change, whether or not it is "appreciated" by the market can only lead to a devaluation of those companies. This is even more likely for foreign investors, who are unlikely to "appreciate" the change.

77 The RBT also notes that the reduction in reported after tax profits may change the behaviour of companies in relation to dividend payments. This is a significant concern for listed companies, for as discussed above, changes in dividend policies by listed companies can give rise to adverse perceptions of those companies in the market.

78 Several of our members have indicated that if a DCT proposal is implemented, they will have no option other than to cease (or at least reduce) paying dividends. The result will be that they will be forced to turn from being treated as an income stock to being seen as a growth stock. The impact of the DCT is highlighted in the detailed example in Section 9.

79 Changes to the tax law should not give rise to such fundamental impacts on taxpayers. It is difficult to see how such a proposal can be considered to be in the interests of a sound, competitive and efficient business taxation system, when the tax system defines the nature of the stock rather than the company itself.

6.4 Reduction in share price for Australian listed companies

80 We submit that the DCT model currently proposed by the RBT will lead to a reduction in the share price of Australian listed companies currently paying unfranked dividends. This reduction will necessarily occur, as these companies will be forced into paying lower cash dividends and will result in a higher tax charge than would otherwise arise (refer to the example in paragraph 73 and in Section 9).

81 The reduction in dividend payout, will occur as a result of the following:

(a) double taxation that will arise due to the treatment of timing differences as tax preferred income – this will impact upon the return to all investors, both domestic and foreign; and

(b) the amount of DCT deducted from the dividend – whilst this will have no impact on domestic investors (as they will receive a credit for the DCT), foreign investors will receive a lower dividend as DCT will be deducted and they will not necessarily get foreign tax credit relief.

82 The effect of this reduction in dividend payout will be to reduce the dividend yield of the company which will necessarily lead to a reduction in the share price of the company. The RBT has argued at 15.38 that the markets and shareholders will need to appreciate the impact of the change on companies deriving significant tax preferred income. Whilst we acknowledged above that the Australian market may appreciate this change, it is unlikely that foreign markets will. The result is a potential outflow of global capital leading to a reduction in these companies' share price and their market capitalisation. In addition, we note that while appreciating the impact of the change, the Australian market will still likely apply some discount to the shares of the affected companies.

83 Our members believe such a reduction in market capitalisation will give rise to an increase in their cost of capital, placing them at a serious

competitive disadvantage in the global capital markets. This impact will be particularly felt by those companies with substantial foreign operations compared to companies with predominately domestic operations, at a time when the Government is trying to encourage foreign expansion and globalisation.

6.5 Reductions in returns to non resident non portfolio investors

84 We are most concerned that the report does not adequately address the fact that DCT will not necessarily be a creditable tax in foreign jurisdictions, but assumes that a foreign shareholder will obtain a credit for DCT. This is not necessarily the case, and demonstrates a lack of understanding of the implications of DCT in the real world. This is disappointing in view of the fact that of the many submissions made to the RBT in relation to the DCT proposals highlighted the potential non creditability of DCT to foreign investors. These concerns appear not to have been addressed by the RBT and for completeness we explain them below.

85 We contend that it is most unlikely that a foreign tax credit will be available in respect of DCT paid by a company. Classical foreign tax credit systems such as those operating in the United Kingdom, the United States and Japan allow non portfolio investors with the requisite ownership interests a credit for underlying tax on distributed profits to the extent that that tax represents a tax on the income or profits of the company. DCT will not be a tax on **income or profits** of the company, but rather will be a tax levied in respect of distributions made by the company. However, as that tax will not be a tax on the shareholder but will be a tax on the entity making the distribution, it will not be creditable for the purposes of the foreign tax credit regime in many of these countries.

86 For example, the UK legislation requires a tax to be "… taxes which are charged on income or chargeable gains and which correspond to United Kingdom corporation tax", *Section 790(12), Income and Corporation Taxes Act, 1988.* We submit that DCT is not a tax charged on income or chargeable gains of an Australian company, and it definitely is not a tax which corresponds to United Kingdom corporation tax.

87 However, we acknowledge that it may be possible to legislate a DCT which would be creditable. This would require careful drafting and we are concerned that the RBT has just assumed this rather than addressed specifically what needs to be done.

88 It should also be noted that DCT could give rise to adverse accounting consequences for non portfolio shareholders. For example, US GAAP requires US companies to provide for any tax payable on the repatriation of their foreign subsidiaries reserves. DCT will therefore require these companies to make an immediate provision of 36% for unfranked reserves (as compared to the likely current provision of 15% for DWT). This will therefore further affect their consolidated profit position.

6.6 Impact on New Productive Investment

89 The impact of DCT on returns to shareholders, both from Australian listed companies and the local subsidiaries of non resident investors is likely to result in a change in the investment behaviour of both types of company.

90 As outlined above, the effect of DCT will be to tax companies on distributed profits sheltered by tax concessions, such as the 125% R&D deduction. This counters the original purpose of the tax concession offered. A number of our members have indicated that this is likely to be a trigger to wind down their R&D activities, or alternatively move those activities to other jurisdictions offering incentives which are already more advantageous than those offered in Australia.

91 Australian subsidiaries of foreign companies are already reporting concerns being raised by their parents as to the impact of DCT on the returns from the Australian operations. DCT, whilst still only a proposal, is a disadvantageous factor for the Australian subsidiaries in the competition to attract additional equity capital from the parent to fund expansion and new investment.

92 Both of the behavioural changes noted above are likely to result in a downturn in the level of new long term productive investment capital injected into the Australian economy.

6.7 DCT exemption for distributions of foreign income

93 One of the concerns of the RBT in relation to allowing a credit for DCT against future mainstream company tax liabilities, is the significant excess credit balances that it believes will be built up in companies on an ongoing basis. The RBT has used the example of surplus ACT in the United Kingdom to highlight the fact that this balance was not

always capable of recovery by the company. On this basis, the RBT considers that this is evidence of the undesirable aspect of credibility of DCT payments against mainstream corporation tax.

94 However, in our practical experience, the build up of large surplus ACT balances in UK companies did not naturally occur as a result of distributions of "tax preferred income" due to timing differences. The build up of surplus ACT balances in the United Kingdom was largely attributable to the requirement for UK companies to account for ACT on distributions of foreign source income which were effectively not subject to tax in the UK due to the availability of foreign tax credits on that income.

95 The build up of excess DCT balances for Australian companies could be avoided if DCT was not levied in respect of distributions of foreign source income.

96 We note the RBT has considered a carve out from DCT for distributions of foreign dividend and other foreign sourced income when passed to non resident shareholders. We consider that such a carve out should also be considered for the distribution of foreign sourced income by resident companies to all shareholders. The absence of such a carve out will diminish the attractiveness of Australia in relation to other jurisdictions such as Singapore where all shareholders benefit from a foreign income carve out.

6.8 Should companies obtain a credit for DCT paid?

97 The RBT notes in paragraph 17.16 that the purpose of DCT is not to act as a defacto entity tax collection system, but that it is a measure to achieve the full franking of dividends.

98 For this reason, the RBT concludes that it is not appropriate to apply DCT to reduce mainstream company tax, as to do so would result in the reinstatement of the tax preferred status of some distributions. The Review notes that "DCT effectively makes up the shortfall in company tax on distributable profits".

99 Further, the RBT notes at paragraph 17.34 that DCT would not be creditable against the future tax liability of the company. This is based on an assumption made in chapter 15 that the double tax cost inherent in applying DCT to tax preferred distributions of income is not considered significant enough to be considered further.

100 The use of this assumption to limit further consideration of this issue is disappointing. The RBT has stated that it is looking to add integrity into the tax system and not to reduce integrity for the sake of practical expediency.

101 We believe that the potential for double taxation may be more significant than the RBT considers. As previously stated, this is critical for certain businesses. The RBT at paragraph 15.51 suggests that entities have some ability to control their distributions to prevent the double tax arising. This may be the case for small closely held companies, however it is unlikely to apply for publicly listed companies who are expected by the market to pay dividends, at least equivalent to that paid last year. To expect these companies to delay dividends to avoid double tax is asking them to risk the market downgrading their performance and a decrease in their share price. An equitable tax system should not place a company in such a position. The RBT's Mission Statement is "To consult on and recommend a sound competitive and efficient business income taxation system for Australia". We submit that issues such as this strike at the heart of the business tax systems competitiveness and efficiency.

102 The purpose of the full imputation system is to give the ultimate taxpaying shareholder a credit for tax that is being paid by the company. This is the essence of a full imputation system. If the Committee has an objective of full franking distributions, this is acceptable, but it should not be with a cost of double taxation at the company level of distributions which are unfranked merely because of the operation of the tax legislation which creates a disparity between the time of taxation of income recognised for accounts and tax purposes.

103 A shareholder should obtain a credit for tax paid by the company under any imputation system, but the company should only pay tax once. This payment of tax can be achieved through the payment of DCT at the time of distribution of tax preferred income, but this should be the first and last time for the taxation of this income. The DCT credit should then be allowed as a credit against the mainstream company tax. If this is not the case, the company will have paid tax twice, once as DCT and once as mainstream company tax.

6.9 How to address Double Taxation?

104 We have discussed above the potential for double taxation to arise on the distribution of tax preferred income created by temporary timing

differences. As noted, the RBT believes that the circumstances where double tax could arise may not be common. We have already expressed our concerns in relation to this dismissal and have called for more detailed consideration on this matter.

105 Despite dismissing the risk of double taxation, the RBT has provided 4 options for dealing with this issue. Our comments on the options are as follows:

(a) refund franking account surpluses on liquidation.

This proposal does not address the issue of double tax at the time that it occurs, though carries a certain amount of logic as eventually all amounts of tax prepaid by a company will be returned (subject to whatever grandfathering provisions are used).

However, this is not a commercially realistic solution, as no company carries on business and makes distributions to shareholders in contemplation of recovering amounts previously paid on liquidation. The basic objective of a company is to create on-going value for its shareholders. Consequently, this ongoing nature of the conduct of companies does not operate in contemplation of liquidation.

(b) allow double tax payments to be offset against company tax liabilities.

We consider that if a DCT model is adopted, then allowing a credit in the circumstances considered by the RBT is only equitable and is in line with the preferred operation of a DCT system that we have outlined above.

(c) allow prepayments of tax of temporary tax preferences.

This is essentially the same as option (b) except that it provides for a voluntary rather than a compulsory payment.

If option (b) or (c) is to be implemented, we suggest that option (b) would be preferable in that DCT would be an automatic payment required in respect of unfranked distributions, but that a credit would be allowed to the extent that an unfranked distribution arose as a result of timing differences.

We do note that it would be necessary to establish a system of identification of permanent and timing differences to enable the identification of unfranked distributions due to temporary tax preferences to take place.

Further, we suggest that corporates would have a view as to whether they would wish for unfranked distributions to be taken first from either the permanent difference component, or the timing difference component. Whilst we suggest that this would make no difference to the amount of DCT that was payable by the company, it would make a difference in relation to whether that DCT was creditable or not. It may therefore be necessary to provide rules which dictate how this decision is to be made.

6.10 Transitional Issues/Tax Losses

106 We are concerned that the RBT has not addressed any of the issues associated with the transition from the current system to any of the new systems and in particular, the DCT.

107 We believe that there are some significant issues with such a transition and these must be addressed.

108 One of the most potentially adverse transitional issues, is the treatment of carry forward tax losses. If a company has such losses carried forward (which may have arisen for a number of reasons, such as actual past losses or timing/permanent differences), then any dividends paid in the short term are likely to be unfranked. As a result, the dividends will be subject to DCT, and the benefit of the losses will be lost.

109 We submit that such a result is totally inappropriate, as the company should be able to operate under the assumption that their losses will be available in the future. Transitional measures need to be put in place to cope with such issues.

6.11 Entity Tax Regime and Branches

110 One impact of the balance of the RBT proposals is the introduction of an entity tax regime, which will bring a whole range of new entities in to the current taxation regime faced by companies.

111 The RBT has failed to consider the impact of the DCT on such entities. For example, there is no clear guidance on the impact of DCT on a branch and this could have significant adverse implications for companies operating through such structures.

112 Branches face complicated issues in applying DCT, such as how to determine profit distributions for any year, ie. is there an automatic distribution or would some form of movement in net asset test apply, would all contributions of cash in be treated as capital and all payments out as distributions?

113 These and many other issues in respect of the application of the DCT to the new entity regime need to be addressed.

6.12 Concluding Comments on DCT

114 The Deferred Company Tax Coalition is disappointed with the comments and analysis of the RBT on DCT, particularly given the level of consultation that has been provided to date to the RBT prior to the release of *A Platform for Consultation*. The Deferred Company Tax Coalition has been heavily involved in this process and it is disappointing to see the comments that we have previously made have not been fully incorporated by the RBT. We are concerned that the comments of the RBT in respect of looking for integrity in the imputation system carry little weight when the RBT is prepared to accept double taxation on the income of entities on the basis that it is not considered significant enough to be addressed further.

115 We are also concerned that the RBT does not recognise that a full imputation system is one that gives the shareholder a credit for all the tax paid by the company and does not necessarily require the company to pay fully franked dividends. If DCT is to be considered as a viable option, and is to be the preferred option of the RBT, then we would suggest that real integrity and fairness could only be added to the DCT regime by:

(a) allowing a credit for DCT payments attributable to timing differences;
(b) carve out from the DCT regime the distribution of tax preferred income arising from specifically provided tax incentives; and
(c) carve out from the DCT regime the distribution of foreign source income to all shareholders, not just non resident shareholders.

116 We acknowledged earlier that the incentive for companies to stream franking credits to shareholders who can obtain the most benefit from them will continue if this model of the DCT is adopted. However, we do suggest that the exempting credit rules contained in *Tax Laws Amendment Act (No 4) 1998* are effective in removing the majority of the source of the imputation credits that were previously traded. In addition, following the introduction of the comprehensive anti dividend streaming provisions, the remaining loss to the Revenue from franking credit streaming is considered not to be significant enough to be of concern.

117 We also submit that if a DCT is implemented then it would be appropriate that the rules in sections 46G to 46M of the Income Tax Assessment Act be repealed.

7 TAXATION OF UNFRANKED INTER ENTITY DISTRIBUTIONS

118 The RBT's third alternative for achieving a full imputation system is for the taxation of unfranked inter entity distributions (other than within corporate groups). There would be no further tax on the distribution when subsequently onpaid as it would now be franked by the tax payment.

119 The advantages of taxing unfranked inter entity distributions would be:

(a) entities which cannot use imputation credits would not be affected; and
(b) the after tax profits of distributing entities would be unaffected.

120 The disadvantages of taxing unfranked inter entity distributions would be :

(a) non residents could be affected in a commercial sense where they have Australian subsidiaries receiving distributions;
(b) the tax liabilities of entities receiving unfranked distributions would be increased;
(c) the incentive for companies to engage in dividend streaming activities would remain, as would the consequential requirement for maintenance of the existing anti avoidance rules in this area; and
(d) this proposal has less integrity in comparison to options 1 and 2.

121 We nominally accept this proposal as a viable alternative and would not have any strong objections to its implementation. However, our acceptance would only be on the basis of a carve-out (i.e. exemption to still apply) for all distributions received by public companies and their subsidiaries, including resident subsidiaries of non resident public companies. This proposal provides the simplest solution and does not give rise to any of the adverse implications of the DCT model.

122 We note that whilst it will facilitate a full franking of distributions passed through corporate chains, it will not facilitate significant incremental franking of dividends paid to ultimate shareholders being resident individuals and superannuation funds. However, we note that this solution is unlikely to provide significant benefits particularly if consolidated groups are introduced.

8 NON RESIDENT INVESTOR TAX CREDIT

123 The RBT has noted that there are inefficiencies in the current Australian taxation system for non resident investors. These inefficiencies arise not only in relation to the existing system of taxation, but also in relation to the DCT proposals. Accordingly, the RBT considers that it is necessary to ensure that any new regime does not unduly raise the cost of capital to Australian business, or have adverse effects on the level of foreign investment necessary for the Australian economy to function effectively and efficiently.

124 We applaud the proposal to implement a NRITC regime which in tandem with a RDWT, achieves the cash collection objectives of the Government whilst actually **encouraging** foreign investment, by potentially increasing the amount of Australian tax that is creditable in their local jurisdiction.

125 We note that, the same can not be said in respect of DCT. This is because the NRITC will only go some way towards reducing the additional cost that DCT would impose on non resident investors. Effectively, the proposal looks to reduce the cost of DCT on unfranked distributions from a 36% non creditable imposition, into a 36% imposition of which 11.29% may potentially be creditable in the investors' home jurisdiction depending upon their tax profile. This is likely to still **discourage** foreign investment.

126 A non portfolio investor currently receiving fully franked dividends will have no amendment made to their effective return through the combination of NRITC and either RDWT or DCT. However, for the non portfolio investor currently receiving unfranked dividends, the combination of NRITC and DCT will still result in a lower effective return than currently exists. The impact of NRITC will mitigate, but not outweigh, the significant additional costs of DCT. This is to be contrasted to the combination of RDWT, where the non portfolio investor will be indifferent.

127 A portfolio investor currently receiving fully franked dividends will be significantly better off, as the operation of NRITC and no DCT/RDWT will mean that part of the currently non creditable Australian tax cost may be creditable in their home jurisdiction. However, for the portfolio investor currently receiving unfranked dividends, the combination of NRITC and DCT will still result in a lower effective return than

currently exists. As for a non portfolio investor, the impact of NRITC will mitigate, but not outweigh, the significant additional costs of DCT.

128 The Deferred Company Tax Coalition endorses the proposal for the introduction of the Non Resident Investor Tax Credit in conjunction with the Resident Dividend Withholding Tax working model.

9 EXAMPLE OF IMPACT OF DCT ON A HYPOTHETICAL COMPANY

9.1 *Assumptions*

129 The example set out below is based on the following assumptions:

(a) the shares in the company are held 50% by resident individuals and 50% by foreign portfolio shareholders;
(b) included in income is $3,000 foreign dividends (net of tax of $1,348) and other foreign income of $425 (net of tax of $75);
(c) the timing differences will reverse in future years and be subject to corporate tax at that time;
(d) the Australian income tax rate is 36%, the foreign tax rate is 35%; and
(e) there is no credit for DCT for the foreign shareholders against tax on their Australian dividend income.

9.2 Summary of Effective Tax Rates

130 The example summarises the effective tax rates in the following circumstances:

	Resident Individual	**Non-resident with foreign income carve-out**	**Non-resident without foreign income carve-out**
Franked profits	48.5%	58.4%	58.4%
Permanent Differences	48.5%	58.4%	58.4%
Foreign Income	64.5%	55.2%	71.3%
Foreign Tax Credits	67.0%	58.3%	73.3%
Timing Differences	67.0%	73.4%	73.4%

9.3 Example

Profit and Loss	**Accounts** $	**Permanent Differences**	**Timing Differences**	**Current Year Taxable**
Sales	20,000			20,000
Cost of Sales	(6,000)			(6,000)
Gross Profit	14,000			14,000
Foreign Dividend Income	3,000	(3,000)		0
Less Operating Costs				
Accounting Depreciation	(2,000)		2,000	0
Tax Depreciation		(2,500)	(2,500)	
Research and Development	(1,000)	(250)		(1,250)
Employee Leave Provisions	(600)		(200)	(800)
Bad Debts Provided	(200)		(50)	(250)
Other Expenses	(5,000)			(5,000)
FTax Credit Gross-up		75		75
Non Deductible Expenses	(50)	50		0
Total	**8,150**	**(3,125)**	**(750)**	**4,275**
Impact @ 36%	**2,934**	**(1,125)**	**(270)**	**1,539**
Foreign Tax Credit		(75)		(75)
Net Tax after FTC	**2,934**	**(1,200)**	**(270)**	**1,464**

Tax Effect Accounting Entries

	DR	***CR***
Income Tax Expense	*1,734*	
Deferred Tax Liability		*270*
Income Tax Liability		*1,464*

Distributable Profits	**6,416**
Impact of DCT if all profits are distributed (see below)	**(1,374)**
Profits available for distribution	**5,042**

ie a 21% reduction

Summary - Resident Individual Shareholder

Component of Dividend	Pre-Tax	Tax Expense at 36%	After Tax Dividend	Actual Tax Paid	DCT	Cash Dividend Paid	Individual Taxable Income
Franked Profits	2,032	731	1,301	731	0	1,301	2,033
Permanent Differences	100	0	100	0	36	64	100
Foreign Income	1,500	0	1,500	0	540	960	1,500
Foreign Tax Credit	67	0	(a) 67	0	24	43	67
Timing Differences	375	135	(a) 240	0	86	154	240
	4,074	866	3,208	731	687	2,521	3,940

(a) These amounts are calculated as the tax saved *64/36

Component of Dividend	Tax @ 48.5%	Imputatn Credit	Addit'nal Tax	Overseas Tax	Addit'nal Tax on Timing Diffs	Total Tax	Effective Tax Rate
Franked Profits	986	731	255	0	0	986	48.5%
Permanent Differences	49	36	13	0	0	49	48.5%
Foreign Income	728	540	188	674	0	1,402	64.5%
Foreign Tax Credit	32	24	8	38	0	70	67.0%
Timing Differences	116	86	30	0	135	251	67.0%
	1,911	1,418	493	712	135	2,757	

Summary - Non-Resident Portfolio Shareholder without Foreign Income Carve Out

Component of Dividend	Pre-Tax	Tax Expense at 36%	After Tax Dividend	Actual Tax Paid	DCT	Cash Dividend Paid
Franked Profits	2,032	731	1,301	731	0	1,301
Permanent Differences	100	0	100	0	36	64
Foreign Income	1,500	0	1,500	0	540	960
Foreign Tax Credit	67	0	67	0	24	43
Timing Differences	375	135	240	0	86	154
	4,074	866	3,208	731	687	2,521

The dividend components above are calculated as 50% of the total and are the same as for the residents

Component of Dividend	Home Country Tax	Overseas Tax	Addit'nal Tax on Timing Diffs	Total Tax	Effective Tax Rate
Franked Profits	455	0	0	1,186	58.4%
Permanent Differences	22	0	0	58	58.4%
Foreign Income	336	674	0	1,550	71.3%
Foreign Tax Credit	15	38	0	77	73.3%
Timing Differences	54	0	135	275	73.4%
	883	712	135	3,147	

Summary - Non-Resident Portfolio Shareholder with Foreign Income Carve Out

Component of Dividend	Pre-Tax	Tax Expense at 36%	After Tax Dividend	Actual Tax Paid	DCT	Cash Dividend Paid
Franked Profits	2,032	731	1,301	731	0	1,301
Permanent Differences	100	0	100	0	36	64
Foreign Income	1,500	0	1,500	0	0	1,500
Foreign Tax Credit	67	0	67	0	0	67
Timing Differences	375	135	240	0	86	154
	4,074	866	3,208	731	122	3,086

Component of Dividend	Home Country Tax	Overseas Tax	Addit'nal Tax on Timing Diffs	Total Tax	Effective Tax Rate
Franked Profits	455	0	0	1,186	58.4%
Permanent Differences	22	0	0	58	58.4%
Foreign Income	525	674	0	1,199	55.2%
Foreign Tax Credit	23	38	0	61	58.3%
Timing Differences	54	0	135	275	73.4%
	1,080	712	135	2,780	