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Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

29 March 2023

Submission: Treasury Laws Amendment (2023 Measures No.1) Bill 2023

To Whom It May Concern,

Naos Asset Management Limited is a funds management business that specialises in investing in public and private emerging Australian companies and is the investment manager for three listed investment companies, investing over $300 million on behalf of over 7,000 shareholders.

We would like to take the opportunity to make a submission to the inquiry into Treasury Laws Amendment (2023 Measures No. 1) Bill 2023, specifically to comment on the proposed legislation within Schedule 4 – Off-market share buybacks and Schedule 5 – Franked distributions funded by capital raisings and voice our opposition to the proposed amendments.

With regard to *Schedule 4 – Off market share buybacks*, under the proposed amendments to off-market share buybacks, not only will a company no longer be permitted to pay franked dividends to shareholders participating in the off-market share buyback, but the company may also have a debit applied to their franking account, potentially impacting the company's ability to pay fully franked dividends in future, despite having the company having paid income tax on earnings.

We oppose this amendment and suggest that this appears to go against the very purpose of the franking system, i.e. to prevent double taxation on company earnings. Off-market buybacks have long been used as an effective capital management tool by many large Australian companies, and we would argue the primary beneficiaries of how these buybacks are currently structured (i.e. with both a capital and fully franked dividend component) are those individuals or organisations in lower tax brackets, such as charities and SMSF members in pension phase. In a time where cost of living pressures are increasing significantly, amending the current legislation in such a manner which will affect those who rely on the benefits of the franking system the most seems to be ill-considered.

With reference to *Schedule 5 – Franked distributions funded by capital raisings*, whilst appreciating the proposed amendments aim to prevent tax avoidance and misuse of the established franking system, we strongly oppose the current draft wording as in our view it is so broad in its current form that a number of legitimate capital raising activities would prevent a company from paying fully franked dividends, which will likely lead to a number of negative outcomes for Australian companies which regard to their resultant capital management decisions.

As an investment manager who specialises in investing in small to mid-cap Australian companies, we would argue that these entities are likely to be unfairly impacted by the proposed legislation when compared to larger companies. Smaller, less established companies are more likely to be on a growth trajectory and as such will often reinvest all profits, and also raise further equity capital to support these growth aspirations, be it through acquisition, investment in fixed assets etc. These companies are less likely to have an 'established practice' of paying regular franked dividends, and the current wording is so broad that any capital raising, at any point in time, could potentially prevent the payment of future franked distributions. Should this eventuate, the likely knock-on effect would be to reduce liquidity and corporate activity in equity markets, which are already suffering in the small-cap space.

We would argue a likely impact of the proposed amendments will be that companies turn to debt instead of equity issuance as part of their capital management strategy, which will significantly benefit larger Australian companies in terms of the likely cost of funding in comparison to what smaller companies are able to achieve. This will significantly increase balance sheet risk across a large cohort of smaller companies, which we believe is an outcome to be avoided in the current macro-economic climate.

Should these proposed amendments be enacted in their current form, another likely impact is that larger companies will likely look to minimise their domestic tax obligations, the impact of which may well significantly outweigh any additional revenue raised by Treasury through the proposed amendments. This will further benefit larger Australian corporations over smaller companies who do not have such optionality.

We are also concerned that common capital management practices such as underwriting dividend reinvestment plans (DRPs) may be caught under the 'established practice' wording in the proposed legislation, should the company not have an established practice of paying dividends, which may well be the case in a growth company, or if a special dividend is declared as a result of abnormal profits. The underwriting of a DRP is an effective capital management strategy commonly used where available free cash is required to be reinvested in the business, particularly in high growth, smaller businesses. The broadness of the current 'established practice' wording potentially preventing such capital management in the ordinary course of operations doesn't appear to be necessary, and a significant deviation from the aim of preventing intentional abuse of the franking system.

In summary, we are strongly of the view that the proposed amendments as detailed above should be revisited and redrafted to ensure that many legitimate capital management activities, and the payment of franked dividends to shareholders are not inadvertently prevented as a result of being caught under the broadness of wording of the current draft legislation, particularly with regard to the 'established practice' test.

Yours sincerely,

[redacted]

Sebastian Evans
Managing Director and Chief Investment Officer
Naos Asset Management Limited