



Australian Foundation
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Received

11 MAY 2007

Board of Taxation

9 May 2007

Mr Brett Heading
Chairman – Off-Market Share Buyback Working Group
The Board of Taxation
c/o The Treasury
Langton Crescent
Canberra
ACT 2600

Dear Mr Heading

I am writing to you in my capacity as Managing Director of Australian Foundation Investment Company (AFIC), Australia's largest listed investment company. As you may know, AFIC has over 80,000 retail shareholders and has over \$5.6 billion invested in the Australian share-market. We are active investors, who communicate frequently both with our shareholders but also with the companies that we invest in.

The Board of Taxation has asked for preliminary submissions on the matter of off-market share buy-backs prior to releasing its discussion paper, when I understand that further submissions will also be invited. As the treatment of off-market buy-backs is a matter of concern to us, and to our shareholders as has frequently been communicated to me and to other members of the Board, I would like to take this opportunity to communicate what we have been saying to companies and what our shareholders have been saying to us.

Off-market share buy-backs as are currently practiced in Australia unfairly stream valuable franking credits to certain classes of shareholders, rather than to all shareholders.

This may be partly a function of the fact that currently franking credits are not shown as an asset on a company's balance sheet. Therefore, although these credits are recognised widely as having value, and a company possessing franking credits is worth more to an Australian-based purchaser than one without, there is currently no mechanism to value these and show them as assets. Our senior executives have been raising this issue with various accounting bodies and standard setters.

In any other situation, it would be inappropriate to distribute a company's assets inequitably to some shareholders but not to others.

Similarly, if they were treated as assets then it would be fair to assume that there could also develop an active market in franking credits. Such a market should not be unwelcome, as franking credits only reflect tax that has already been paid over to the Treasury, and would enable companies who cannot utilise these credits to obtain some value for them.

As has been widely discussed in the media, we are currently in a very strange position whereby a company making a buy-back maintains that it is paying a dividend as it has a franking credit attached to the payment (and obviously the ATO agrees), whilst legally it cannot be a dividend because the Corporations Act states that each share in a class of share has equal rights to a dividend.

The value that can be attached to these franking credits can also be seen by the very high scale-backs seen on some of the recent off-market buy-backs (up to 79.8% in the recent case of Alumina Ltd). This indicates that the arbitrarily set maximum discount of 14% at which the buy-back price may be set relative to the current market price results in a serious undervaluation of the franking credits attached to the buy-back consideration.

The obvious solution - the strengthening or clarification of the law to insist that a dividend if paid must be paid to all shareholders - will not impact upon a company's ability to manage its capital by buying-back shares, as it can continue to do so on-market, and at a price determined by the entire market rather than the advantaged shareholders who benefit from the artificial discount limit.

As a company, I should also note that we cannot claim the capital 'loss' generated by participating in these buy-backs. Individual shareholders are permitted to claim this tax loss. This further exacerbates the concern regarding the inequitable treatment of some shareholders.

This is, of course, a brief summary of what we regard as the issues - we would be very happy to expand further on them in a meeting should that be of assistance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ross Barker', with a long horizontal flourish extending to the right.

Ross Barker
Managing Director