Submission to Taxation review

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[removed for privacy reasons]

Model for the application of flexible dividend arrangements that incorporate franking credits paid by mutual ADI's to member shareholders.

Mutual Australian Deposit taking Institutions (ADIs) in Australia (Building Societies, Credit Unions and the like) have been subject to paying income tax on retained earnings for over a decade.

Whilst the payment of income tax on retained earnings has placed mutual ADIs on a similar taxation footing to Commercial Australian owned ADIs, shareholder members of mutuals have been placed at a disadvantage compared to their brethren shareholders in commercial ADIs through the inability to enjoy the benefit of a franked dividends or other financial distribution.

Furthermore the collection of franking credits over the past decade places the mutual sector as a whole at a commercial disadvantage with respect to takeover and amalgamation. The accumulated franking credits may be used for financial benefit of the shareholders of a commercial ADI following the takeover of a mutual, in a manner unavailable to a mutual organisation.

Whilst, it might be argued that the members of a mutual may benefit from a higher takeover price that would reflect the the value of the franking credit to a potential suitor, under current tax arrangements this is likely a sub optimal outcome for mutual members for the following reasons:

- Mutual shareholders must sell their share and cede control in order to benefit from the franking credit as an asset.
- The inability of potential mutual suitors to compete on price will result in a constraint to the competition that would be available if suitors were bidding on an equal (or at least more equivalent) footing.

I propose that the review consider allowing mutuals to pay financial benefits to members that would incorporate a franking credit.

In the interests of fairness and to reflect the mutual nature of the organisations concerned I would suggest that the scheme might have the following characteristics:

- The payment would be made retrospectively following a surplus period (the 'period') for the ADI, at the discretion of the Board.
- If paid, the payment to individual members may vary and be determined by the Board in a manner that is consistent with a predetermined and published policy.
- The payment to individuals should reflect the value that the member has contributed to the mutual through their investments, loans, payment of fees or use of other services. For example
    - An investor might be granted a bonus interest payment relative to their deposit balance during the period;
    - A lender may receive a reimbursement of a portion of interest paid during the period.
    - A high transaction user might be granted a refund of a portion of their transaction fees during the period.
    - A user of services may be granted a bonus payment relative the their use of services and the value of those services to the mutual.
    - All members may be grated a special dividend, that is consistent with the pre existing

policy.

It is not my intention to advocate the benefits and stability of the Australian Mutual ADI sector here, as such material is otherwise comprehensively published. However it should be noted that these organisations are all Australian owned by Australian taxpayers, they are locally managed, and nationally regulated – and in the current financial crisis the Mutual ADI's have held up well with low rates of mortgage default and strong cash-flows. Mutual ADI are currently contributing to a stable financial system in Australia.

Inadequacy of Current Arrangements

Whilst it is currently the case that a mutual may reduce its pre tax surplus by providing reimbursementss of fees and interest, or otherfinancialal incentives to members as part of a marketing strategy in any given tax yearMutuall ADIs are currently constrained from returning surplus capital to members in a comparable manner to commercialcompetitors.. This proposal permits mutual to manage Capital, and return benefits to members in a more equitable manner that is currently possible. The application of franking credits would provide the possibility of more transparent strategies for temporal equity where benefits are returned to those members who had actually contributed during a given period. The current options for marketing / behavioural incentives provides neither an accurate indication to regard to actual contributed value by individual members, nor a basis for capital management of any surplus by a Board.

I believe that a reform along these lines will both promote greater transparency and competition in the Australian Financial sector. Furthermore it will remove an anomalous taxation disadvantage that shareholder members of mutual ADI's are currently subject to compared to shareholder-customers of commercial ADI's.