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INVESTMENT COMPANY

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11 September 2008

AFTS Secretariat
The Treasury,
Langton Crescent,
PARKES
ACT 2600

Dear Sir or Madam,

SUBMISSION WITH REGARDS TO AUSTRALIA'S FUTURE TAX SYSTEM – "ARCHITECTURE OF AUSTRALIA'S TAX AND TRANSFER SYSTEM"

Treasury has called for written submissions from the Australian community with regards to the Review of Australia's Future Tax System and the August 2008 paper entitled 'Architecture of Australia's Tax and Transfer System'.

I am writing as Managing Director of Australia's largest Listed Investment Company which commenced operations in 1928 and now represents over 85,000 shareholders, primarily domestic and retail. Shareholders invest with us as an efficient and cost effective way of investing in the Australian stock market. In this way they look to access over the medium to long term a stream of growing fully-franked dividends as well as capital growth of their investment.

Retention of the dividend imputation system

The introduction of the current dividend imputation system in 1987, and the end to taxation of the same income twice, was a significant advance in Australian taxation history. It has ensured that Australia has one of the most sensible and forward-thinking taxation regimes in the world when it comes to the taxation of corporate income. The principle of ensuring that shareholders are not effectively taxed twice on the same profits is a sound one.

Many of our shareholders are retired or access their dividends through their superannuation fund. The dividend imputation system which allows shareholders to reclaim franking credits (equivalent to the underlying company tax paid) on dividends from companies in which they invest ensures they are not penalised by receiving their income via a dividend stream. Shareholders with low or nil tax rates can claim refunds of some or all of the franking credits and thus enhance their income.

We strongly support the retention of the dividend imputation system as beneficial to our shareholders and encouraging investment by small shareholders in the corporate sector. We believe any proposal to discontinue the dividend imputation system would be an extremely retrograde and damaging development for the stock market, for the corporate sector and for investors individually.

In this regard we believe any move to restrict the reclaiming of dividend franking credits to superannuation funds alone would also be similarly negative. The dividend imputation system should continue to be available to all domestic shareholders.

Tax Driven Company Share Buy-Backs

One of the unanticipated developments arising out of the dividend imputation system has been the practice of companies to use their surplus franking credits by buying back their shares off-market using a substantial component of franked dividend income as part of the buy-back consideration. This allows the particular shareholders who participate to obtain significant benefits from those franking credits which are fully or partially refunded by the Government.

We strongly oppose this practice as it streams franking credits to a particular group of shareholders. It has the further unwanted characteristic that to access these benefits one has to sell one's shares and exit the investment. As a long term investor we believe that franking credits should be distributed with dividends to all shareholders on a pro rata basis and that shareholders should not have to sell their holding to access that stream of surplus franking credits.

Alternatively, we recommend consideration be given to allowing a market in franking credits to develop so that companies with surplus franking credits could on-sell them to other parties to enable value to be obtained for all shareholders. This would be a far more transparent way of dealing with surplus franking credits rather than the current artificial process of off-market buy-backs of shares structured to use up the franking credits.

Removing the disparity of treatment of capital gains and income

We recommend that the Government legislate to ensure that certain investment vehicles are not disadvantaged compared to others with respect to the treatment of capital gains. Legislation has been enacted to provide that all gains made from the sale of securities are deemed to be on capital account for superannuation funds. This enables such funds to bypass questions raised by some interpretations of the principles laid down in the *London Australia* tax case with regards to when investments are held on "revenue" account and when they are held on "capital" account.

Legislation should be enacted to ensure that other pooled investment vehicles and Listed Investment Companies through which Australians are encouraged to save benefit from the same clarification. This would bring certainty to what is a very difficult area and give all Australian investors greater confidence to increase their levels of saving.

In summary, Australian Foundation Investment Company ("AFIC") calls for the following :

1. Retention of the dividend imputation system which enables all Australian shareholders to access franking credits equivalent to the rate of taxation charged on company profits, so that the profits are not taxed twice.
2. Legislation to allow companies with surplus franking credits to realise their value through a market mechanism rather than tax driven off-market share buy-backs.
3. Legislation to provide consistency in the treatment of the "revenue" versus "capital" distinction as between superannuation funds and other investment vehicles including Listed Investment Companies.

I would be happy to expand on any of the above points at your request.

Yours sincerely

Ross Barker
Managing Director