

Mr. Joseph Longo
Chairman
Australian Securities and Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

Via Email: markets.consultation@asic.gov.au

Re: Submission in Response to ASIC Discussion Paper: Australia's Evolving Capital Markets

Dear Chairman Longo,

Wilson Asset Management is an Australian fund manager established in 1997, investing \$5.8 billion on behalf of more than 130,000 retail investors. This submission is provided in response to the Australian Securities and Investment Commission (ASIC) Discussion Paper, "Australia's evolving capital markets: A discussion paper on the dynamics between public and private markets" (the Discussion Paper).

The purpose of this submission is to provide a detailed and critical response to specific questions posed in Appendix 1 of the Discussion Paper, namely Questions 4, 5 and 6. This submission explains how the regulatory environment with the Proposed Taxation on Unrealised Gains in Superannuation, is a central threat to the vibrancy and longevity of capital markets. We then advance a central thesis: that the cumulative impact of policy instability and specific legislative changes affecting the Australian dividend imputation (franking credit) system has, and will continue to, significantly and negatively influence the attractiveness, structure, and overall health of Australia's public capital markets.

This submission will first address Discussion Questions 4, 5, and 6 sequentially, incorporating analysis of relevant market factors. It will then dedicate a specific section to detailing the detrimental impacts of historical and, particularly, recent changes to the franking credit system, including Schedules 4 and 5 of the *Treasury Laws Amendment (2023 Measures No. 1) Act 2023* (the TLA Act 2023). Finally, we will conclude with specific recommendations for consideration by ASIC.

1. Response to Discussion Question 4: Regulatory Focus

Discussion Question 4 asks: *What developments in public or private markets require regulatory focus in Australia in the future?*

Addressing this question acknowledges that the Discussion Paper references that taxation can impact capital markets. We agree that taxation can impinge capital formation for both private and public companies. Recently we wrote a discussion paper, titled "*Critiquing the Proposed Taxation on Unrealised Gains in Superannuation*," articulating significant concerns we have with the legislative proposals to tax unrealised capital gains within superannuation funds, named *The Treasury Laws Amendment (Better Targeted Superannuation Concessions and Other Measures) Bill 2023* (the Bill). We encourage ASIC to review our paper and have attached a copy with this letter for your perusal.

The proposal to impose an additional tax at a rate of 15 per cent for unrealised superannuation earnings, corresponding to the percentage of an individual's superannuation balance that exceeds \$3 million, marks a substantial deviation from established taxation principles. Taxing hypothetical profits, which are essentially

paper gains that could diminish or disappear before being converted to cash, challenges the perceived fairness and predictability of the tax system.

Our concerns with the Bill's application are multiple. Yet to address the terms of the Discussion Paper, we foresee a future primarily whereby listings on the Australia Stock Exchange (ASX) will shrink. We detail in our paper a potential \$94.5 billion deadweight loss to the Australian economy, representing lost economic welfare and \$155 billion of investments moving out of Self-Managed Superannuation Funds (SMSF's) into tax exempt structures like primary residences. As SMSF's allocate the majority of investments to Australian Equities, the pool allocated to the ASX will very likely shrink. This in turn creates idiosyncratic risks for the remaining assets listed on the ASX, leading to higher market concentration in a few select names, lower market liquidity, and then in turn, an unwillingness of listed companies to be listed on the ASX. Global examples from Sweden, Norway and Spain highlight the potential for the unforeseen secondary impact of capital flight.

In relations to private markets, we detail in our paper how Canva, an Australian success story, could well have not been created if we tax unrealised gains within superannuation. This is because the Venture Capital and Private Equity industry will be severely damaged, as they will not be able to undertake and finance mark to market revaluations. Startups will simply move offshore.

The central objection in our paper is not to the proposed increase in the tax rate to 30% for balances exceeding \$3 million, rather it is to the fundamental principle of taxing profits that individuals may never actually realise. This approach is characterised as an illogical and unfair legislative change, with potentially severe negative consequences for individuals and the Australian economy.

2. Response to Discussion Question 5: Enhancing Public Market Attractiveness

Discussion Question 5 asks: *"What would make public markets in Australia more attractive to entities seeking to raise capital or access liquidity for investors while maintaining appropriate investor protections?"*

Addressing this question requires acknowledging the context highlighted in the Discussion Paper: a trend of declining net listings on public markets in Australia, contrasted with significant growth in private markets. Ensuring Australia's public markets remains a vibrant and appealing venue for capital formation and investor liquidity is paramount for the broader economy.

The Franking Credit Dimension: A Critical Attractiveness Factor Undermined/A powerful competitive advantage

This submission contends that the stability and effectiveness of Australia's dividend imputation system represents a unique and powerful competitive advantage for the Australian public markets, particularly in attracting domestic capital and leveraging the cost of capital for Australian businesses. Its progressive erosion directly undermines the attractiveness of listing and investing in Australian public companies.

The discussion around market attractiveness frequently centres on the trade-offs between access to capital and liquidity versus costs and regulatory burden. However, for Australia's significant pool of domestic, tax sensitive capital – notably the ~\$4 trillion superannuation system and numerous retiree investors – the after-tax return differential driven by franking credits is a more significant determinant of public market attractiveness than marginal changes in listing fees or standard compliance burdens.

Franking credits provide a tangible, quantifiable boost to after-tax returns, specifically for these domestic investors, estimated at between 1% and 2% per annum on average for the ASX 200. Policies that reduce the value of these credits (e.g., debates around removing refundability) or introduce complexity and uncertainty regarding their availability (such as Schedule 4 and 5 of the TLA Act 2023) directly diminish the incentive for this crucial capital pool to favour ASX-listed equities over alternatives like global equities or unlisted assets. This reduced demand inevitably impacts market liquidity and company valuations, making listing less attractive for companies seeking access to this deep pool of domestic capital. Therefore, franking policy is not merely a factor, rather a primary lever influencing the attractiveness of Australian public markets to its largest domestic capital base.

Furthermore, changes to the franking system negatively impact the perceived regulatory burden as companies evaluate the total cost and risk profile of being public, encompassing explicit compliance costs and the broader regulatory environment. Complex and policy uncertainty around changes to fundamental tax rules, exemplified by Schedule 4 and 5 of the TLA Act 2023, introduce a significant layer of unpredictable tax regulatory risk. This risk pertains to core corporate activities such as capital management and shareholder distributions. This tax-specific uncertainty adds to the overall perceived burden and complexity of operating as a listed entity, tipping the balance away from the ASX for companies contemplating staying private or pursuing delisting. Changes to the franking legislation mean that public companies are now unfairly penalised and operate at a significant disadvantage to unlisted companies.

In the year 2024 alone, The TLA Act 2023 has led to \$6.0 billion of franking being stripped from companies listed on the ASX. If those same companies were not listed on the ASX they would still have \$6.0 billion of franking today to distribute to their shareholders. This affects both individual investors and over 4.2 million retirees in Australia who rely on franking credits, thus diminishing the incentive to invest in the ASX. **One must remember franking is actual tax paid on behalf of investors that is being stripped by the Australian Taxation Office (ATO).**

Proposed Measures for Enhancement

To make Australian public markets more attractive:

- **Restore Franking System Stability and Predictability:** The most critical measure is to provide policy stability regarding dividend imputation. This includes reversing detrimental changes, particularly repealing Schedule 4 and 5 of the TLA Act 2023 (as discussed further in Section 4) and providing certainty regarding the ongoing refundability of credits. This restores confidence and the unique value proposition franked dividends offer to domestic investors.
- **Meaningful Regulatory Streamlining:** Support ASIC's simplification agenda, to ensure efforts translate into tangible reductions in compliance complexity and cost, especially for small and mid-cap listed entities, without compromising essential investor protections.
- **Promote Long-Term Investment Perspectives:** Explore mechanisms, potentially non-regulatory or market-led, to encourage a greater focus on long-term value creation within public markets, mitigating short-term pressures that continuous reporting obligations place on listed companies compared with unlisted companies.

Global Context: The UK Cautionary Tale

The experience of the United Kingdom provides a stark warning regarding the potential consequences of dismantling a dividend imputation system. The UK abolished its Advance Corporation Tax (ACT) system, similar in intent to Australia's franking credits, in 1999. In the subsequent decades, institutional ownership of UK-listed equities plummeted dramatically, with pension funds and insurance companies shifting capital

offshore or into alternative, often lower-return, asset classes like fixed income. This has been attributed to the re-imposition of double taxation on dividends, making domestic equities less attractive. The consequences have included diminished retirement savings outcomes, damage to London's reputation as a financial centre, and UK companies increasingly seeking funding and listings elsewhere. This contrasts sharply with the Australian experience where dividend imputation has historically encouraged domestic investment in local companies. While other government policies like targeted tax incentives exist, their effectiveness can be context-dependent, reinforcing the view that maintaining a stable and effective imputation system is a key policy lever unique to Australia's circumstances.

3. Response to Discussion Question 6: Economic Impact of Declining Public Listings

Discussion Question 6 asks: *"Do you agree that a sustained decline in the number, size or sectoral spread of listed entities would negatively impact the Australian economy? If so, can you suggest ways to mitigate any adverse effects that may arise from such changes?"*

This submission strongly agrees that a sustained decline in the health of Australia's public equity market would have significant adverse effects on the Australian economy. For over five hundred years, since the first stock exchange in Belgium, equity markets have been the pathway for emerging companies to access capital, as well as providing an indicator of the mood of a nation.

Today the ASX is a \$2.7 trillion market, the eighth largest in the world, with a potential pool of over 2,100 available investments. Whilst total listings are unchanged over the past decade, an important overlooked fact is that the market now includes over 350 Exchange Traded Funds, so the decline in listings is worse than reported in the Discussion Paper. Further, whilst the market capitalisation of the ASX has doubled in a decade, Australia has halved in its share of global market capitalisation.

Specific Negative Economic Impacts

A shrinking or stagnating public market manifests in several detrimental ways:

- **Reduced Capital Formation and Innovation:** Public markets provide a crucial and efficient mechanism for companies, including those in growth phases, to raise capital from a diverse investor base. A decline limits these avenues, potentially stifling business expansion, innovation, and job creation.
- **Diminished Market Depth, Diversity, and Liquidity:** Fewer listed entities, particularly across diverse sectors, lead to a narrower, more concentrated market. This reduces investment choices, increases portfolio risk for investors, including large superannuation funds managing retirement savings, and may fail to reflect the dynamism of the broader economy. The higher concentration can in turn lead to reduced diversity and negatively impact market liquidity.
- **Impact on Superannuation and Retirement Outcomes:** Australia's \$4 trillion superannuation system is a major participant in the ASX. A less diverse, potentially lower-returning domestic equity market directly impacts the retirement savings of millions of Australians. If declining public market opportunities or diminished franking benefits force funds towards potentially less transparent or lower returning alternatives, long-term retirement outcomes suffer putting strain on the aged pension.
- **Increased Cost of Capital:** A less vibrant public market with potentially lower domestic demand (linked partly to weakened franking incentives) could increase the cost of equity capital for Australian businesses needing funds. It is changes to franking that impact the cost of capital.

The Link Between Franking Credit Policy and Market Decline

Policy instability and the erosion of the benefits provided by the dividend imputation system contribute directly and indirectly to the declining health of public markets. The system acts like a flywheel: valuable, predictable franking credits attract domestic capital, supporting liquidity and valuations, which in turn encourages listings, providing diverse investment opportunities for that capital. Damaging this system initiates a negative feedback loop: reduced credit value or increased uncertainty diminishes domestic demand, potentially lowering liquidity, and valuations, thus discouraging new listings and making delisting or staying private more attractive. This cycle harms both issuers seeking capital and investors seeking returns, negatively impacting the broader economy.

Furthermore, the consistent focus in policy debates on the short-term budgetary impact of franking credit measures often overlooks significant potential long-term costs. Reduced

retirement incomes resulting from lower superannuation returns or direct cuts to retiree income streams can accelerate reliance on the Age Pension. This increased future fiscal burden may outweigh any immediate budget savings, representing a substantial, often uncoded, negative economic consequence of policy instability in this area.

Proposed Measures for Enhancement

To mitigate the adverse effects of a declining public market:

- **Prioritise Franking System Stability:** As argued in the response to Question 5, restoring stability and predictability of the imputation system is paramount. This involves legislative amendments (repealing Schedule 4 and 5 of the TLA Act 2023) and policy certainty regarding refundability.
- **Reduce Barriers to Listing:** Continue efforts to streamline listing rules and reduce compliance costs and complexity, particularly for smaller companies, potentially reviewing ASX fee structures.
- **Ensure Conducive Broader Policy Settings:** Maintain stable corporate tax settings and general economic policies that foster business investment, productivity and growth.

4. The Detrimental Impact of Franking Credit System Changes on Australian Capital Markets

The Australian dividend imputation system, introduced by the Hawke-Keating government in 1987, was a landmark reform designed to eliminate the double taxation of company profits distributed as dividends to Australian resident shareholders. By providing shareholders with a 'franking credit' representing company tax already paid, the system aimed to create tax neutrality between distributed profits and other forms of income, and importantly, remove the tax bias favouring debt finance over equity. The system, particularly following the introduction of refundability for excess credits in 2000, is widely credited with encouraging broader Australian participation in equity markets and contributing to a reduction in corporate leverage levels over time.

However, subsequent changes and policy instability surrounding the imputation system have cumulatively eroded its benefits and introduced significant uncertainty, negatively impacting Australian capital markets. This 'death by a thousand cuts' effect, stemming from multiple adjustments and proposals over the years (including 1997 eligibility rules, the 2000 introduction of refundability followed by debates over its removal, a 2002 ban on preferential streaming, the 2019 election on franking credits, and recent 2023 legislative interventions), has created significant policy instability. Even if individual changes are presented as targeted integrity measures, the overall consequence is an erosion of confidence and predictability in a cornerstone

tax policy, making Australia a less attractive and more complex environment for equity investment and corporate capital management.

Key Negative Changes and Their Impacts

Several specific changes or proposed changes warrant detailed consideration:

- **Uncertainty Regarding Refundability:** Although currently retained, the political debate in recent years to remove the refundability of excess franking credits has created lasting uncertainty. Removal would disproportionately harm low-tax rate investors, including retirees, superannuation funds (especially those in pension phase), and charities. It would significantly reduce their after-tax returns from Australian equities (by up to 30% on the dividend component for pension phase members), distort investment choices away from domestic shares, introduce unfairness by effectively imposing a minimum 30% tax on dividend income for these groups, and potentially increase long-term reliance on the Age Pension. The lingering threat of such a change continues to cast a shadow over the system's stability. Franking must be retained to keep the ASX vibrant.
- **Treasury Laws Amendment (2023 Measures No. 1) Act 2023 (TLA Act 2023):** This Act introduced two schedules specifically impacting franking credits:
 1. **Schedule 4 (Off-market Share Buy-backs):** This schedule amended the ITAA 1936 and ITAA 1997 by inserting at Subsection 205-30 (1) 9A and Subsection 205-30 (1) 9B of the TLA Act 2023 words to align the tax treatment of off-market buy-backs by listed public companies with on-market buy-backs by preventing the dividend component of the buy-back price from being franked. This removes a capital management tool previously available to ASX listed companies. Criticisms have also been raised that it fails to achieve full alignment with on-market buy-backs due to the retention of market value substitution rules for determining the capital component, potentially creating ongoing complexity. Hidden in the detail of this legislation is the fact that a listed company that undertakes any share buy-back will have their franking account reduced on a per share basis or are forced to pay franking deficit tax to the ATO if they don't have franking credits available. Both shareholders and the company lose out as these companies will permanently lose the amount of franking that previously would have been distributed to shareholders changing the goal posts of what was previously applied.
 2. **Schedule 5 (Franked Distributions Funded by Capital Raisings):** This schedule amended the ITAA 1997 (inserting paragraph 202-45 (ea.) and section 207-159) to render a distribution unfrankable if it is not consistent with an entity's "established practice," there has been an associated issue of equity interests, and it is reasonable to conclude the "principal effect" of the equity issue was to fund the distribution. The stated policy intent was to prevent "inappropriate release of franking credits" through contrived arrangements. However, this schedule has drawn significant criticism for its severe negative impacts. For example, it
 - **Creates Complexity and Uncertainty:** The legislative tests ("established practice," "principal effect," "funded by") are inherently ambiguous and create significant uncertainty for companies undertaking routine capital management or M&A activities. This necessitates complex judgments by companies and the ATO, potentially hindering efficient decision-making. While ATO guidance (PCG 2024/D1) attempts clarification, substantial uncertainty persists.
 - **Hinders Legitimate Commercial Practices:** The provisions risk capturing ordinary commercial transactions, such as raising capital for growth initiatives. This consequently hinders paying special dividends as part of takeover schemes where funding is implicitly linked to the overall transaction financing. This represents a potential disconnect where a policy aimed at curbing perceived avoidance inadvertently hampers legitimate market activities.

- **Disrupts Mergers and Acquisitions:** Schedule 5 introduces major uncertainty for the prior widespread practice of paying fully franked special dividends alongside control transactions. This complicates directors' duties in assessing deal structures, makes it difficult for independent experts to value proposals, and potentially leaves selling shareholders worse off if credits are unexpectedly denied post-transaction. The measure creates a specific disincentive for raising equity capital if there is any link, however indirect, to dividend payments, potentially pushing companies towards less optimal debt financing.

Summary Table of Negative Changes:

The following table summarises key recent changes and proposals negatively impacting the dividend imputation system:

Change/Event	Year(s)	Key Provision(s)	Primary Negative Impact(s) Cited
Uncertainty over Refundability	Ongoing (esp. 2019 proposals)	Potential removal of cash refunds for excess franking credits.	Reduces after-tax returns for low-tax investors (retirees, super funds, charities); distorts investment; increases complexity/unfairness; potential increase in pension reliance.
Buy-back Changes	2023	Schedule 4, TLA Act 2023: Prevents dividend component of off-market buy-backs by listed companies from being franked.	Removes capital management tool; potential incomplete alignment with on market buy-backs due to retained market value rules; increased complexity.
Distributions Funded by Capital Raising	2023	Schedule 5, TLA Act 2023 (s207-159): Makes certain distributions unfrankable if linked to capital raising outside established practice with principal funding effect.	Creates significant complexity and uncertainty; hinders legitimate capital management and M&A (special dividends); discourages equity raising/promotes debt; disproportionate response to perceived issue.

Broader Economic Consequences of System Erosion

The cumulative effect of these changes extends beyond individual companies or investors:

- **Investment Distortion and Capital Allocation:** Weakening the unique benefits of imputation reduces the incentive for Australian investors, particularly large superannuation funds, to maintain their 'home bias's towards domestic equities. This could lead to capital flowing offshore or into less transparent private markets, potentially reducing the pool of equity capital available for Australian firms, especially small to medium enterprises less able to attract foreign investment.
- **Increased Cost of Capital:** A diminished domestic investor appetite for Australian equities, driven by reduced franking benefits or increased policy risk, can logically lead to an increased cost of equity capital for local companies seeking funding.
- **Reduced Market Efficiency:** The uncertainty, complexity, and potential for hindering normal commercial transactions introduced by changes like Schedule 4 and Schedule 5 detract from overall capital market efficiency.

- **Impact on National Savings and Retirement Incomes:** As previously noted, negative impacts on superannuation fund returns and direct income reductions for retirees have implications for national savings objectives and the adequacy of retirement incomes, potentially leading to greater reliance on social security.

5. Concluding Remarks and Recommendations

This submission has argued that while several factors influence the dynamics between public and private markets, the stability and integrity of Australia's dividend imputation system play a uniquely critical role in the health and attractiveness of our public equity market. The responses to Discussion Questions 5 and 6 highlight how the erosion of franking credit benefits and associated policy instability function as a significant deterrent to listing, contribute to negative economic consequences stemming from market decline, and fundamentally shape investor expectations alongside traditional regulatory and community pressures.

The overarching concern is that piecemeal, complex, and unpredictable changes to a foundational tax policy like dividend imputation create substantial headwinds for Australian capital markets. Recent legislative interventions, particularly Schedule 4 and 5 of the Treasury Laws Amendment (2023 Measures No. 1) Act 2023, exemplify how measures aimed at integrity protection can inadvertently stifle legitimate commercial activity, introduce profound uncertainty, and damage investor confidence, potentially outweighing any narrow fiscal objectives.

A vibrant, efficient, and trusted public market is essential for Australia's economic prosperity. Achieving this requires a stable, predictable, and internationally competitive regulatory and tax environment. Addressing the detrimental impacts of recent franking credit legislative changes is a crucial step towards this goal. Therefore, this submission makes the following recommendations for consideration by ASIC and, through ASIC's advocacy, the Government:

1. **Advocate for Repeal or Substantive Amendment of Schedule 5 (TLA Act 2023):** We strongly recommend that ASIC actively advocate for the repeal, or at minimum, significant amendment of Schedule 5 of the TLA Act 2023. The uncertainty and impediment it poses to normal capital market operations, particularly M&A transactions, and routine capital management, are substantial and detrimental. Alternative approaches, such as utilising existing anti-avoidance provisions (e.g., Part IVA, s177EA), should be relied upon for addressing genuinely contrived arrangements.
2. **Recommend Removal of Schedule 4 Implementation (TLA Act 2023):** We recommend the removal of the practical application of Schedule 4 to ensure it restores the ability of companies to undertake capital management initiatives and not be restricted by franking credit deficit taxes.
3. **Support Certainty on Franking Credit Refundability:** We urge ASIC to support policy certainty regarding the ongoing refundability of franking credits, acknowledging its critical importance for the fairness and integrity of the imputation system and its significant positive impact on retirees, superannuation funds, and charities.
4. **Promote Dividend Imputation Policy Stability:** Advocate for a period of stability and predictability concerning dividend imputation rules. Future proposed changes must be subject to thorough consultation that genuinely considers broad capital market impacts, efficiency, and fairness, not solely narrow integrity concerns or short-term fiscal estimates.
5. **Advocate for changes to the Taxation of Unrealised Gains on Superannuation Bill:** We strongly recommend ASIC advocate for modifications to the Bill that encourages superannuation as an asset class to support capital formation by including indexation on the \$3.0m threshold to 8.2 percent per annum (in line with the 100-year return for Australian Equities), allowable gearing with SMSF's, and consideration of how to deal with mark to market movements for private companies.

6. **Continue Support for Regulatory Simplification:** Endorse and encourage ASIC's ongoing efforts to reduce unnecessary regulatory complexity and compliance costs for listed entities, ensuring that simplification enhances efficiency without compromising core investor protections.

Restoring confidence in the stability and fairness of the dividend imputation system is essential for maintaining the attractiveness and vitality of Australia's public capital markets. We thank ASIC for the opportunity to provide this submission and welcome further dialogue on these important matters.

If you have any questions on our submission, you can contact me on 0412 242 712, or email gw@wilsonassetmanagement.com.au, or Chief Financial Officer Jesse Hamilton on 0401 944 807 or email jesse@wilsonassetmanagement.com.au

Yours sincerely,

Geoff Wilson AO
Chairman & Chief Investment Officer
Wilson Asset Management (International) Pty
Limited

Jesse Hamilton
Chief Financial Officer
Wilson Asset Management (International) Pty
Limited