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FRANKING CREDITS IN TAKEOVERS

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Legal Briefings – By **Toby Eggleston**

SUMMARY

- Despite frequent comment in the media to the contrary, franking credits may be valuable to foreign acquirers.
- This means that assertions that target companies should simply pay a franked dividends as that will not cost the bidder anything may be incorrect.
- Paying a dividend in a takeover bid also creates great complexity.

There has been recent comment in the media that a bid or scheme involving a foreign acquirer will be more attractive if, once the price has been agreed, the offer is structured so that, to the greatest extent possible, the target pays a franked dividend and the cash paid by the bidder is correspondingly reduced.

This is on the basis that franking credits attached to franked dividends are of more value to the selling shareholders and have 'little or no value' for foreign bidders. See, for example, the comments by Forager Funds in respect of Jangho's offer for Vision Eye in 2015.

In our view this comment is not always correct.

First, from the foreign buyer's perspective, a franked dividend is *not* subject to Australian withholding tax. An unfranked dividend will be subject to withholding tax at a rate of between 5% or 15% if the holding entity is resident in a country with which Australia has a double tax treaty, or 30% if not (such as the Cayman Islands or Hong Kong – jurisdictions which are often used by Chinese acquirers).

Accordingly, foreign bidders may fully value the franking credit if it would shelter dividends from a 30% withholding tax, providing the target with the ability to pay cash out of the Australian group free of withholding tax

Second, it is not always the case that shareholders would be better off receiving a franked dividend in lieu of cash consideration, particularly if the dividend is considered to form part of the capital proceeds from a CGT perspective. This is likely to be the case if the dividend is a critical element of the bid and is funded by the purchaser. For example, a shareholder who has a capital loss may prefer to utilise the loss then receive an assessable dividend. Further, a shareholder who makes a loss on sale of the shares will have that loss reduced by the amount of the assessable dividend (even though this is effectively double taxing the dividend).

Finally, paying franked dividends in the context of a takeover bid is complex and would generally require an ATO class ruling to ensure that shareholders are in fact entitled to the benefit of the franking credit. The initial bid structure for Warrnambool Cheese & Butter takeover bid created an unworkable situation and had to be re-structured and is a stark reminder of the complexities in this area.

Accordingly, it is important that companies get advice in advance to understand the ramifications of paying franked dividends in takeovers and schemes before agreeing this as part of the bargain.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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