Wilson Asset Management

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Productivity Commission
Pillar 1: Creating a more dynamic and resilient economy
Submitted electronically via: 5pillars@pc.gov.au

Submission to the Productivity Commission's Interim Report for a More Dynamic and Resilient Economy

Wilson Asset Management welcomes the opportunity to respond to the Productivity Commission's Report, 'Creating a more dynamic and resilient economy' ('Interim Report') and supports the efforts of the Commission to reinvigorate Australia's productivity.

Wilson Asset Management is an Australian fund manager established in 1997, investing $6 billion on behalf of more than 130,000 retail investors. As the investment manager of nine listed investment companies (LICs) and three unlisted funds, we have deep knowledge of public and private markets, and the role that business investment plays in our economy. Our business, and those we invest in, will be significantly impacted by any changes to corporate taxation and regulation. We are therefore pleased to contribute to this critical national conversation by sharing our experience and insights to drive business investment to deliver a more dynamic and resilient Australian economy.

In this submission, we respond to the Productivity Commission's requests for information that relate to our expertise (Information requests 1.1 and 1.2) and provide two additional suggestions which will significantly improve productivity.

- Appendix 1: Response to Information Request 1.1 – The interaction between the proposed cashflow tax (i.e. net cashflow tax) and Australia's dividend imputation system.
- Appendix 2: Response to Information Request 1.2 – The most appropriate way to tax financial services in a manner that is consistent with the proposed changes and induces additional capital expenditure in a similar manner to the NCT.
- Appendix 3: We strongly urge the Productivity Commission to recommend **against** the Government's proposed legislation to tax unrealised gains on superannuation balances above $3 million.
- Appendix 4: We propose the Productivity Commission recommend the expansion of corporate bonds and attach franking credits to corporate bonds. The expansion of Australia's corporate bond market will enable businesses to unlock a growing pool of domestic savings. One requirement would be the establishment of a ratings agency for corporate bonds to support retail uptake. The introduction of franking credits for corporate bonds will open a liquid retail market for Australian businesses, particularly within the superannuation system. Extending Australia's dividend imputation system to the interest payments on corporate bonds will also help achieve tax neutrality between debt and equity.

We broadly support the direction of the Productivity Commission's work, in particular the lowering of the corporate tax rate for small companies and reducing regulatory red tape. As a financial services firm subject to industry funded regulation, we continue to support regulatory simplification. We endorse and encourage the ongoing efforts to reduce unnecessary regulatory complexity and compliance costs for listed entities, ensuring that simplification enhances efficiency without compromising core investor protections. An efficient and trusted public market is essential to encourage business investment.

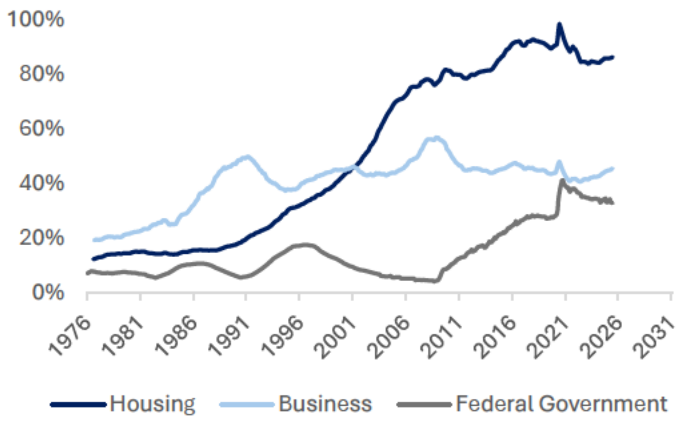
The importance of business investment

A decade of stagnant productivity growth, compounded by a decline in business investment is eroding national prosperity and constraining wage growth. Data from the Australian Bureau of Statistics (ABS) suggests that a major reason for this is the flattening out of the capital-to-labour ratio. To improve productivity growth, efforts need to be made to deepen capital stock in the economy, and in the right ways. The usual areas for capital deepening revolve around taxation, such as more generous research and development incentives or accelerated depreciation provisions. We believe these are worthwhile areas to pursue reform, however, from a market perspective, more can be done to improve funding in the economy.

In terms of financial capital, it is hard to argue that Australia is lacking. Bank loans and fiscal deficits create deposits, and private and public credit creation has grown over many decades. Outside of measured bank deposits are funds in superannuation (with deposits in superannuation excluded from the technical definition of bank deposits). The issue is not the quantum of financial capital, but the quality of it, and how it flows to the real economy.

Most of the money created in the financial system is occurring via government spending or mortgages. Some government spending is useful in boosting productivity, for example, in infrastructure. Other forms are not, for example, directed towards consumption. As for mortgages, banks have strong return on equity and "safe collateral" incentives to lend to housing, though it is also well documented that housing is one of the least productive forms of capital stock in the economy.

Financial Capital Flows: Housing, Business and Government



Source: ABS, RBA, Wilson Asset Management

What is lacking is the proportion of financial capital being created by, and directed to, business. Reform is required to unlock more productive financial capital and ensure that it flows to the real economy in ways that incentivise its deployment in the most productive ways and to the most productive sectors.

Therefore, it is worthwhile thinking about obstacles to generating more business credit, whether via the banking system, or outside of it. We explain further our recommendation to expand the corporate bond market's role in this regard in Appendix 4.

Currently, the Government is proposing a tax on unrealised gains in superannuation accounts above $3 million. This tax will have a significant negative impact on productivity as it undermines capital deepening.

Without urgent action, the long-term economic consequences will be severe for Australian workers and our economy. This underscores the importance of the Productivity Commission's work to drive productivity to unlock private business investment, and the high stakes of getting reform right.

If you have any questions on our submission, please call me on [redacted] or Chief Financial Officer Jesse Hamilton on [redacted] or email Olivia Harris at [redacted]

Yours sincerely,

[redacted]

Geoff Wilson AO
Chairman
Wilson Asset Management

Appendix 1: Response to information request 1.1: The interaction between the proposed net cashflow tax (NCT) and Australia's dividend imputation system

We strongly recommend the Productivity Commission ensures the continuation of the current dividend imputation policy settings, originally introduced to eliminate double taxation of company earnings. The current system is widely accepted, ensures business profits are ultimately taxed at marginal rates and creates incentives for business and equity investment, particularly superannuation funds and retirees, resulting in several broad economic benefits:

- Lower cost of capital: By making after-tax returns on Australian equities more attractive, franking credits encourage domestic investment and reduce the cost of equity capital for Australian companies. This supports capital formation, especially for small and medium enterprises that rely on local investors, rather than these investments flowing offshore or into opaque private markets.
- Equity over debt: By removing the prior tax bias favouring debt, the imputation system has encouraged equity-based funding for businesses from retail investors, keeping Australia competitive. As Paul Keating stated in 1987, this shift 'improves the overall climate for productive investment and job creation.'
- Longer term holdings: To receive franking credits investment time periods must be met. This ensures investment behaviour is oriented towards long-term capital formation, which in turn gives businesses confidence to invest.
- Market attractiveness and regulatory confidence: The system is seen as a unique competitive advantage of Australia's public markets and is why, in part, the Australian equity market attracts an equity multiple premium over other countries. Erosion of franking through legislative uncertainty or complexity deters listing on the ASX and creates a competitive disadvantage on listed companies compared to their unlisted counterparts.
- Market liquidity: The current system strengthens demand for ASX-listed equities among tax sensitive investors, contributing to market liquidity and resilience, particularly during periods of volatility.
- Support for long-term ownership and national savings: Franking credits provide steady, tax-effective income streams that are particularly valuable for retirees. This supports retirement income and reduces future pressure on the aged pension system.

The dividend imputation system in its current form promotes a more efficient allocation of capital. It encourages companies to distribute profits rather than retain them inefficiently. This return of capital to shareholders enables them to reinvest it in other, potentially more productive, opportunities and provides critical income for retirees, taking pressure off the aged pension and allowing the government to invest in other productive areas.

We are concerned that the NCT is a piecemeal change to the corporate tax system that disrupts foundational tax policies like the dividend imputation system. Adoption of the net cashflow tax would see a wide disparity of net effective tax rates and franking rates for companies depending on investment cashflows. The complexity for investors and businesses in needing to understand multiple taxation regimes would create significant confusion as taxes paid would be occurring on two separate lines of the profit and loss statement. In summary, implementing a net cashflow tax would undermine the achievement of many of the Productivity Commission's stated principles and objectives.

It would also create substantial headwinds for Australian capital markets. We can draw lessons from Britain's Advance Corporations Tax (ACT), a similar system to Australia's dividend imputation, designed to prevent double taxation. Britain abolished its imputation-style system in 1999 after a series of government changes undermined its value. Since then, institutional ownership of UK-listed companies has collapsed, with pension and insurance funds' holdings falling from 38.7% in 2000 to just 4.3% by 2020, with much of the capital fleeing to overseas markets and alternative assets.

We recommend that if the NCT tax is adopted, NCT payments should generate franking credits. If there is uncertainty about franking credit treatment for NCT payments, companies may be reluctant to declare franked dividends, reducing the supply of franking credits available to investors. If the NCT does not generate franking credits, or if franking becomes diluted, after-tax yields on dividends will decline, making Australian equities less attractive relative to global assets and significantly increasing corporate Australia's cost of capital.

We outline our proposal for the expansion of franking credits to corporate bonds in Appendix 4.

Appendix 2: Response to Information request 1.2: The most appropriate way to tax financial services in a manner that is consistent with the proposed changes and induces additional capital expenditure in a similar manner to the Net Cashflow Tax.

We strongly recommend the exclusion of passive investment income including dividends and distributions, and investment entities, from the NCT. Without such exclusions, capital expenditure will be disincentivised, as cash flows would be taxed at the underlying business level, then taxed again as a net cashflow of an investment entity before being taxed as income in investor hands.

Appendix 3: We submit that the Government's proposed tax on unrealised gains on superannuation balances over $3 million should not proceed as it would impose significant costs on capital formation and productivity.

We believe the exclusion of the proposed tax on unrealised gains in superannuation from the Interim Report is an oversight, as its design and economic effects are directly relevant to the Commission's focus on business investment and regulatory burden. The proposed tax would undermine the very productivity outcomes we are all attempting to strengthen, while increasing compliance complexity and undermining capital deepening

Taxing unrealised gains will:

- **Discourage investment and capital deepening:** By taxing gains that have not yet been realised, the policy penalises long-term, productive investments and reduces the pool of capital available for reinvestment. This drains resources that would otherwise expand Australia's capital stock and improve the capital-to-labour ratio. Our research estimates society will be worse off by $94.5 billion, the deadweight loss from taxation.
- **Reduce capital mobility and productive allocation:** The proposal creates a lock-in effect, discouraging investors from reallocating capital to more productive uses. Instead of flowing into innovation, infrastructure and businesses that enhance capital deepening, an estimated $155 billion in superannuation assets could shift into tax-free holdings such as the primary residence, further exacerbating the housing affordability crisis, and encouraging investment into housing, one of the least productive forms of capital stock in the economy.
- **Erode confidence in long-term capital formation:** By undermining trust in the stability of Australia's $4.2 trillion superannuation system, the tax weakens one of the nation's most important mechanisms for accumulating and deploying long-term savings into productive investments. Without policy certainty, superannuation funds will hesitate to back projects that build the deeper capital base needed for sustained productivity growth.

We urge the Productivity Commission to recommend against the adoption of the proposed taxation on unrealised gains on superannuation balances over $3 million in its Final Report.

We proposed an alternative solution in our submission to the Economic Reform Roundtable titled Build Economic Resilience and Support Australian Aspiration by Taxing Superannuation Logically: The Progressive Super Surcharge and Tax Offset. Economic modelling contained in our two discussion papers, 'Critiquing the Proposed Taxation on Unrealised Gains in Superannuation' and 'Taxing Aspiration and Innovation into Oblivion: How the Unrealised Gains Tax and the Failure to Index Will Decimate Australia's Innovation', contends that such a tax brings with it significant unintended consequences and is detrimental to Australia's productivity.

Key findings from our research include:

- **Erosion of the innovation ecosystem**: Taxing unrealised gains redirects capital away from start-ups and into private credit and debt, stalling initial public offerings (IPOs) and limiting retail investment. This reduces access to angel and venture capital, potentially reducing future tax revenue by 53%. As artificial intelligence (AI) and green technology drive the next wave of innovation, we risk undermining Australia's competitiveness.
- **Capital drought for emerging companies**: Smaller, often pre-profitability companies rely on external capital to fund research, development and growth. The proposed tax will make it significantly more difficult for these entities to attract investment, increasing the risk of failures and shrinking the pipeline of future Australian success stories.
- **Start-up flight**: Each year, 55,096 corporate start-ups are expected to be captured by the taxation of unrealised gains. As a result, we estimate an annual loss of $444.3 million in taxation revenue once these companies reach the mature stage of the S-Curve.
- **The flight from prudent risk-taking**: Self-managed superannuation funds (SMSFs) will be forced to abandon growth-oriented investments. The need to manage annual tax liabilities will drive a shift towards lower-risk assets, or top ASX 100 listed companies. This reallocation will deprive innovative companies of critical funding and contribute to dangerous levels of market concentration and potential overvaluation in large-cap stocks.
- **Asset movement to tax exempt structures**: Australia could see $155 billion in assets move into tax exempt structures such as the primary residence, with housing being one of the least productive forms of capital stock in the economy.
- **Lost taxation revenue**: 611,823 Australian start-ups or small growth companies are projected to forgo $19.73 billion in taxation contributions to the Government during the maturity phase of the S-Curve life cycle.
- **Cryptocurrency**: While cryptocurrency represents 1% of total SMSF assets, it accounts for 7% of newly established SMSF portfolios. The historical drawdown in cryptocurrency has exceeded 80%, raising serious concerns about the ability for an investor to meet tax liabilities on hypothetical gains when there is a medium to high probability those gains will reverse the next year. This challenges the reliability of Treasury's tax revenue forecasts which assume taxable cryptocurrency gains.

Appendix 4: Incentives for corporate funding through franked bonds

We agree with the Interim Report's assessment that Australia's corporate tax system is a significant barrier to the investment that will drive productivity growth for a more dynamic and resilient economy. The headline tax rate of 30% is internationally uncompetitive, and its structure contains biases that distort investment decisions, favours debt over equity and imposes significant complexity on businesses seeking to invest and grow in Australia.

Australia is an outlier among developed economies. This creates a negative first impression for mobile international investment. The OECD Corporate Tax rate average is 23%, with United Kingdom at 25%, United States 21%, Singapore 17% and Ireland 12.5%. We understand the dividend imputation system can complicate direct comparisons, however, the high headline rate unequivocally places Australia at a competitive disadvantage.

Looking beyond the corporate tax rates, a primary impediment to business investment in Australia is the underdeveloped nature of our domestic corporate bond market, particularly for retail investors. The RBA has repeatedly noted that Australia's corporate bond sector remains small by international standards, with many issuers, especially those with lower credit ratings, still tending to seek capital abroad. Parliamentary inquiry findings quantify the extent of this observation, showing that corporate bonds represent only 10% of non-financial organisations' total funding in Australia, compared to an OECD average of 40%[1].

Building resilience into the economy through bond market lending

The Australian bond market is overwhelmingly dominated by wholesale investors, such as banks and large funds, with more than 95% of Australian bonds by value historically issued into this segment. Retail participation is exceptionally low, with direct holdings by private investors accounting for less than 1% of all corporate bonds on issue, a figure that pales in comparison to the 20% seen in the United States. This lack of a deep and liquid retail market means Australian businesses are denied access to a vast and growing pool of domestic savings, particularly within the superannuation system.

This underdevelopment creates a significant systemic vulnerability for the Australian economy. It forces Australian companies into an excessive reliance on only two primary sources of funding: domestic bank debt and offshore capital markets. This concentration of funding sources makes the national economy less resilient to financial shocks, a concept known as the "spare tire" theory. In the event of a domestic banking crisis that curtails lending, or a global credit crunch that closes off offshore markets, Australian businesses would have few alternative sources of capital, potentially leading to a severe investment downturn and economic contraction. A domestic retail corporate bond market would offer Australian companies an alternative source of capital, reduce excessive reliance on domestic bank debts and offshore capital, enhance national financial stability and address the Commission's objective of fostering a more 'resilient economy'.

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1 https://www.aph.gov.au/Parliamentary_Business/Committees/House/Former_Committees/Tax_and_Revenue/CorporateBondMarket/Report/section?id=committees%2Freportrep%2F024469%2F72985

Streamlining regulation by establishing a bonds ratings agency

The growth of a retail corporate bond market in Australia is currently inhibited by a burdensome regulatory framework that is misaligned with investment risk. Under the *Corporations Act 2001*, issuers of corporate bonds to retail investors are generally required to produce a full, detailed prospectus document. Submissions to numerous government inquiries have consistently identified this requirement as costly, onerous, time-consuming and a primary deterrent to issuance. This regulatory framework is illogical because it inverts the appropriate relationship between risk and disclosure. It imposes a higher and more complex disclosure burden on the issuance of senior, lower-risk corporate debt than it does on higher-risk equity capital raisings by listed entities or on complex, high-risk hybrid securities. This regulatory inconsistency actively discourages the creation of safer, simpler investment products for retail investors and represents a clear case of the 'excessive or inappropriate regulation' that the Commission seeks to remove.

The establishment of a robust and accessible credit rating system for retail corporate bonds is a solution to the "Reduce the impact of regulation on business dynamism" pillar of the Commission's inquiry. The current regulatory framework, which relies on a costly and complex prospectus for investor protection, can be reformed by leveraging the informational efficiency of credit ratings. By providing a reliable, independent, third-party assessment of risk, a formal rating significantly diminishes the need for the existing disclosure regime. The proposed reform would involve amending the *Corporations Act* to create a streamlined disclosure pathway for issuers of investment-grade rated bonds to retail investors. Instead of a full prospectus, eligible issuers could use a much simpler document, like a term-sheet.

Extending Australia's dividend imputation system to corporate bonds

As a first of its kind, tax reform should also centre on extending Australia's dividend imputation system to the interest payments on corporate bonds, thereby achieving tax neutrality between debt and equity for domestic retail investors. Since the introduction of dividend imputation, equity has become the dominant source of corporate funding. From 2015 to mid-2025, ASX-listed companies raised approximately $741 billion in equity compared with only $42 billion in corporate bonds (ex-financials). This reflects how the system supported equity-based funding for businesses. This highlights both the effectiveness of the dividend imputation system in promoting capital raisings, and the relative weakness of debt markets, which remain concentrated and largely inaccessible to retail investors. Extending the imputation system to debt markets could broaden funding channels and reduce this imbalance.

Under this proposal, a company issuing an eligible 'franked bond' would be able to attach a franking credit to its interest payments, representing the corporate tax paid on the earnings used to fund that payment. For a retail bondholder, the tax treatment would be identical to that of a shareholder receiving a franked dividend. According to the ICE Bank of America, the market capitalisation of the corporate bond master index in Australia is $181 billion. At an average bond yield of 4.7%, this is approximately $8.6 billion per annum worth of coupon payments. If corporate bonds were to be grossed-up[2] in a comparable manner to equities, approximately $12.3 billion per annum would be available in fully franked income to retail investors of corporate bonds, with $3.7 billion in franking.

The impact of this reform on the after-tax returns for a low-tax-rate investor, such as a superannuation fund in the accumulation phase or Australian charities, is material. The current system penalises bond income relative to franked dividend income for this investor class, and so this proposed reform creates a level playing field, making corporate debt a more attractive investment. Additionally, the proposed reduction in the corporate tax rate will shrink the pool of franking credits available. Extending imputation to bond income would encourage equilibrium between debt and equity investments in Australia. It would also help preserve the effectiveness of the imputation system and encourage investment into Australian businesses through bonds, strengthening the domestic bond market and increasing overall capital expenditure in the economy.

Conclusion

We commend the Productivity Commission's commitment to long-term reform and urge it to be ambitious in its final recommendations. We are optimistic about what will be achieved. Our proposed reforms build upon the work underway, are informed by evidence and shaped by experience. They offer a clear pathway to revitalise private sector investment that will drive productivity growth.

This is a generational opportunity to reset the foundations of Australia's economic model. Our vision is an economy where private capital is deployed with confidence, knowing that policy settings are stable and globally competitive, and regulation is efficient and focused on measurable outcomes rather than red tape. It is time to implement bold reforms that create tangible impact, with more capital flowing into Australian companies that bolster jobs, boost wages and ultimately, contribute to a more dynamic and resilient economy.

[2] Grossed-up yield includes the value of franking credits and is based on a tax rate of 30.0%.