AUSTRALIAN FOUNDATION INVESTMENT COMPANY

# Tax Transparency Report

2018-2019

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# 1. Introduction

Australian Foundation Investment Company Limited ("AFI" or "AFIC") is a Listed Investment Company as defined in the Income Tax Assessment Act 1997 s 115.290.

AFIC is listed on the Australian Securities Exchange and the New Zealand Securities Exchange (code "AFI") and its shares may be purchased or sold via a broker. Full details regarding the Company's corporate history, Board & Management, Corporate Governance, Financial Statements and Annual Reports and dividend payment are available via its website www.afi.com.au

AFIC through its Board and Investment Committee manage the Company's portfolios of investments. It has an arrangement with Australian Investment Company Services Limited (an entity in which AFIC has a 75% share) to provide administrative and operational services.

Listed Investment Companies (LIC) which make capital gains upon which tax is payable on the sale of investments held for more than one year are able to attach to their dividends a LIC capital gains amount which some shareholders are able to use to claim a tax deduction. For more details, see the Company's Annual Report.

As a listed company with approximately 140,000 shareholders, AFIC is fully compliant with Principle 6 of the "ASX Governance Principles" in respecting the rights of security holders. As part of that, the Board of AFIC maintains that this includes being transparent about the taxation affairs of the Company.

The Board has therefore determined that AFIC should publish a Tax Transparency Report in accordance with the Voluntary Tax Transparency Code as developed by the Board of Taxation and released as part of the Federal Budget in May 2016.

As AFIC is a Listed Investment Company with operations only in Australia, it has no international related party dealings or offshore financing or tax concessions.

Shareholders and other stakeholders should be aware that AFIC was recently part of the ATO's Streamlined Assurance Review for the income years ended 30 June 2014, 30 June 2015 and 30 June 2016 (2014, 2015 and 2016 income years). They found that AFIC paid the right amount of Australian income tax for the relevant years, and AFIC received the highest possible rating for all areas reviewed, including its Tax Risk Management and Governance.

# 2. Approach to Tax Strategy and Governance

## Tax Strategy & Governance

The Board has a formal policy in place with regards to taxation strategy. This is disclosed below :

""The Board of Australian Foundation investment Company Limited ("AFIC") seeks to meet its obligations with regards to current and future taxation on its activities in a manner that maintains its reputation as a responsible and secure vehicle for its shareholders' funds.

AFIC will prepare tax returns and disclose its tax positions based on its', and its advisers', interpretation of current taxation legislation and consistent with ATO guidance, where applicable.

AFIC's strategy is to provide the best investment outcome for its shareholders consistent with its stated goals. This by necessity will not involve utilising high-risk taxation-driven strategies.

Unless a range of taxation outcomes are specifically provided for under the legislation (e.g. parcel selection for Capital Gains Tax), if there is a possibility that a transaction or range of transactions could be taxed in different ways, or if there is a difference of views, AFIC will usually seek to record the transaction in a conservative manner consistent with legislation and ATO guidance.

Management and their advisers will inform the Board either directly or through the Audit Committee when such a disparity of outcomes exists, whilst being mindful of materiality and reputational risk.

AFIC will meet its taxation obligations in a timely manner and will ensure that the policies, procedures and practices are maintained to meet this policy."

A standing item on the Board Meeting Agenda allows Management to provide the Board with an update on taxation matters, consistent with the above policy.

In addition, the Board's Audit Committee receives the reports from the external auditor (see below) on their review of the taxation balances (including calculations) at the half-year and year-end.

As an LIC that invests primarily in Australian listed assets, the Company's tax affairs are relatively simple, and relate to income tax payable on the distribution that it receives (whilst accounting for any attached franking credits) plus the net income from interest and option trading, and tax on the capital gains that it makes from its investments held on capital account. Much of the tax paid and franking credits received are passed onto AFIC's shareholders in the form of franked dividends.

## Taxation Risk Management

The Board of Australian Foundation Investment Company Limited is responsible for overseeing the operations of the Company and ensuring that sound system of internal controls are in place for risk management purposes.

This includes taxation risk, which is defined by the Company as the risk that the Company takes a tax position that is not in accordance with its risk appetite and/or the risk that the amounts of tax due are incorrectly calculated, provisioned for and/or paid.

The Board receives assurances from the Managing Director and the Chief Financial Officer ("CFO") twice yearly regarding the operation and effectiveness of the Company's internal controls (see the Corporate Governance Statement available on the website).

The Board has approved the overarching risk appetite of the Company and is assisted in its risk management activities by the Audit Committee. Coordination of risk management activities, including taxation risk, is done by the Chief Financial Officer, who reports to the Audit Committee on such matters.

The Risk Management Framework is reviewed by the Audit Committee on an annual basis, and such a review has been carried out this financial year. The framework has been developed to take into account the principles and guidelines outlined in AS/NZS ISO 31000: 2009 Risk Management – principles and guidelines. This approach involves establishing the context in which it operates, identifying the risks, analysing those risks, evaluating the risks, treating the risks where appropriate and monitoring, reviewing and reporting risks and the overall performance of the framework.

AICS as the provider of administrative and operational services to the Company has its own risk management processes and controls, including taxation risk and taxation policies and procedures. The efficacy of these internal controls is reported to the Company's Audit Committee via an ASAE3150 report from the AICS internal auditor, Ernst & Young.

With regards to calculation of and provision for taxation, the Company notes the following controls that are in place to reduce the risk of material misstatement:

- Company's tax returns are prepared by external advisers (PricewaterhouseCoopers, who are also the Company's auditors).
- Company's provisions for tax payable are reviewed twice a year by the auditors as part of the annual and half-yearly audit and review. This includes franking credit balances and LIC gain accounts.
- Company's auditors perform a review, on a sample basis, of the Company's capital gains in the year to attest to the accuracy of the record-keeping with regards to the tax cost-base of securities sold, and thus the amount of Capital Gains Tax incurred.

## 3. Reconciliation of Accounting Profit for the year ended 30 June 2019 to Taxes Payable at 30 June 2019

| | 2019<br>$'000 |
|---|---|
| Profit for the year before tax | 421,529 |
| Nominal tax at 30% | 126,459 |
| Less : net effect of franking credits on dividends received | (115,510) |
| Less : over provision in 2018 | (2,132) |
| Add : various items taxable but not included in profit | 6,339 |
| Total tax expense for the year per P&L | 15,156 |
| Add : Capital Gains Tax for Year on realised gains (incl. gains on revenue account) | 20,394 |
| Total tax charge 'incurred' for year including Capital Gains Tax | 35,550 |
| Less : PAYG tax for year already paid | (19,212) |
| Less : foreign tax credits | (592) |
| Add back : timing differences (i.e. movements in deferred tax assets and liabilities) etc. | 1,306 |
| Total tax payable per Balance Sheet at 30 June 2019 | 17,052 |

# 4. Effective Company Tax Rates

As per the figures in Section 3. above :

| | 2019<br>$'000 |
|---|---|
| Profit for the year before tax | 421,529 |
| Total tax expense for the year per P&L | 15,156 |
| **Effective Tax Rate** | **3.6%** |

The profit figure also includes items that are not taxable but included as profit for accounting, such as the demerger dividend from the Coles demerger from Wesfarmers, nor the full amount received from the off-market buy-backs from BHP and Rio Tinto.

These figures do not include the tax that has already been paid on the dividends that the Company has received. Franked dividends that AFIC receives are not free from tax. Instead, the tax (at 30%) has already been paid on the profits from which these dividends are sourced.

Imputation instead acts to ensure that these same profits are not taxed twice – by the company that paid the dividend to AFIC and then by AFIC itself or even three times – by the original paying company, by AFIC and then by the shareholder on receipt of a dividend from AFIC.

Including the imputation or franking credits, therefore, and adjusting for the demerger dividend the effective tax rate would be as follows :

| | 2019<br>$'000 |
|---|---|
| Profit for the year before tax | 421,529 |
| Adjustment for demerger and off-market buyback dividends | 6,695 |
| Adjusted profit | 428,224 |
| Net effect of franking credits on dividends received as income | 115,510 |
| Total tax expense for the year per P&L | 15,156 |
| **Tax Expense including franking** | **130,666** |
| **Effective Tax Rate including franking** | **30.5%** |

Excluding prior-year adjustments, the rate would be 30%.

This is equivalent to the prior year's figure which was also an effective tax rate of 30%.

## 5. Reconciliation of Taxes payable at 30 June 2019 to Taxes Paid for the 2018-19 year

| | $'000 |
|---|---|
| **Tax Payable as at 30 June 2019** | **17,052** |
| Less : PAYG instalment subsequent | (1,238) |
| Less : Tax Payable by subsidiary | (350) |
| Less : Income deferred and other adjustments per annual tax statements received after year-end from trusts that the Company invests in | (3,562) |
| **Tax payable per Tax Return for 2018-2019** | **11,902** |

# 6. Total Taxes Paid Summary for the year ended 30 June 2019

As well as corporate income taxes paid, AFIC and its subsidiary AICS and their employees pay a number of other taxes.

AFIC's total tax contribution is summarised below :

| | $'000 |
|---|---|
| Tax Payment per Tax Return | 11,902 |
| Tax paid in advance via PAYG (incl. July 2019) | 20,036 |
| Total corporate income tax paid | 31,938 |
| Tax pre-paid by companies that AFIC invests in received as franking credits on dividends (incl on off-market buy-backs) | 164,785 |
| Foreign taxes paid (after tax-return adjustments) | 592 |
| Total corporate income tax borne by AFIC | 197,315 |
| Irrecoverable GST incurred by AFIC | 543 |
| PAYG on salaries withheld by AFIC Group | 2,891 |
| Payroll tax incurred by AFIC Group | 353 |
| FBT incurred by AFIC Group | 5 |
| GST collected by AFIC Group | 1,288 |
| **Total tax contribution of AFIC for the 2018-19 year** | **202,395** |

## 7. Reconciliation of Accounting Profit for the Year Ended 30 June 2019 to Taxable Income

The accounting profit is not the same as taxable income due predominantly to the franking credits and foreign tax credits received, plus the adjustments to accounting income noted in Section 3.

| | **$'000** |
|---|---|
| Accounting Profit before tax per 2019 Annual Report | 421,529 |
| Less Profit of subsidiary (taxed separately) | (2,532) |
| Accounting profit of AFIC as taxable entity | 418,997 |
| | |
| Losses from investments on revenue account | (3,819) |
| Unrealised loss on trading portfolio | 771 |
| Gains from investments on capital account | 70,939 |
| Income accounted for in past years | 43,468 |
| Income not taxable in current year | (43,601) |
| Demerger dividend not taxable | (43,629) |
| Off-market buy-backs not included in revenue | 50,323 |
| Minor items non-taxable | (515) |
| Franking credits received | 164,785 |
| | |
| **Taxable income** | **657,719** |
| | |
| Tax payable at 30% | 197,315 |
| Tax paid overseas | (592) |
| Gross tax pre-paid by companies that AFIC invests in received as franking credits on dividends | (164,785) |
| | |
| **Total tax paid or payable** | **31,938** |