

argue that gains on defeasances are taxable, then it could be argued by the taxpayer that these gains should be offset with the losses arising on the re-assumption of the defeased liability.

In addition, it could be argued that the future interest payments for which the company remains responsible should be an allowable deduction on the basis that the original debt obligation has been re-assumed by the company. A similar scenario could be applied to defeasance transactions that were structured with the primary obligation for the liability being assumed by a third party.

The question is: can a company that has previously defeased debt assume a future debt obligation from another party, without actually re-assuming its original principal debt obligation? In other words, can future principal payment obligations be assumed by a company from a third party and the future interest payment obligations of the original defeased debt matched against the principal debt obligation being assumed? Must it be shown, from a tax viewpoint, that the interest payments relate to the obligation assumed, or must the company re-assume its original debt obligation in order to gain an allowable deduction for the interest payments?

The transactions described above would obviously be costly and the gains or losses arising would depend on the movement of long-term interest rates between the original defeasance and the re-assumption of that obligation. It will be necessary for a company and its advisers to weigh the costs of such transactions against the costs of likely tax assessments. It must also be noted that the recent change in corporate tax rates from 49 per cent to 39 per cent will have the effect of reducing the potential benefits from such transactions.

After experiencing the evolution of defeasance transactions in Australia over the past five years in a vacuum of both accounting and taxation regulations, we have suddenly seen a rapid awareness of this financing technique by the Australian accounting bodies and the Commissioner for Taxation.

We will no doubt see, within the next year, a large number of companies that are adversely affected by the current developments turning to their corporate advisers in an attempt to mitigate their effect. Analysts will need to be alert to the potential impact of defeasance transactions on the financial position of affected companies. □

## VIEWPOINT

# THE CASE FOR THE CORPORATE SENATE

Sir,

Readers of JASSA may be interested in details of a proposal I have made to the National Companies and Securities Commission on the adequacy of the law and of the Australian Stock Exchange listing rules on protecting the interests of the shareholders when a substantial shareholder disposes of his interest.

The submission, made in July, followed a public invitation by the NCSC and was based on a presentation I made in September 1987 to a privatisation seminar organised by the Company Directors' Association of Australia Limited.

I said in the submission that the law and listing rules provide inadequate protection to shareholders. At the same time, they are too cumbersome to facilitate and expedite changes in substantial shareholdings and share structure. Greater investor protection and corporate flexibility could be achieved by introducing various elements of self-governance.

A key proposal is a requirement that all listed corporations establish an elected audit/shareholders' committee which I describe as a corporate senate.

It is already a requirement in the US that corporations with publicly traded securities have audit committees. But audit committees in the US are not independent of the board and so cannot be effective in either overseeing or controlling directors. Nor do the US audit committees represent the interest of the small shareholders.

A corporate senate would be elected on the basis of one vote per shareholder rather than one vote per share. The senate would be under the control of the small shareholders. It would thus be a suitable body to delegate the approval of changes in controlling interests. However, any decision of the senate could be over-ruled by a 75 per cent vote by shareholders at a general meeting with the traditional one vote per share.

In my submission to the NCSC I propose changes to the ASX listing rules so that:

- all listed companies have a corporate senate; and
- the articles of listed corporations require that the corporate senate approve

the registration of changes in substantial shareholdings.

If corporate senates were required for all listed corporations, then they could be used to facilitate and expedite changes in corporate structure in cases which now require meetings of shareholders. The senate would, however, provide greater protection for small investors.

A three-member elected corporate senate was established earlier this year by JAC Tractor Limited (JTL), with which I am associated. The duties and powers which the senate exercises on behalf of the shareholders include:

- nominating auditors for election by shareholders and nominating any advisers whose advice is to be used in any report to shareholders;
- approving any issue of shares except pro-rata bonus issues;
- determining accounting policies to be used in any report to shareholders;
- approving the form and content of all reports to shareholders or the public;
- stating views on any proposal by the directors to change the articles of the company, authorised capital, issued capital, or the number of directors, or any proposal by the directors in relation to mergers, take-overs, reconstruction or the issue of options or shares;
- approving all matters in which a director has a conflict of interest including all contracts in which a director has an interest.

It should be noted that the senate has no power to initiate any action which affects management. It has veto powers only in those situations where the directors could have a conflict, or in matters which directly affect the rights of shareholders or the information provided to shareholders.

I would be happy to provide, to anyone interested, further details of the JTL initiative.

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*JASSA welcomes letter to VIEWPOINT on any matters of interest to the securities industry.*