PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

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Board of Taxation Secretariat
The Treasury – Melbourne Office
Level 6, 120 Collins Street
Melbourne VIC 3121

By email: CGTRollovers@taxboard.gov.au

Dear Sir/Madam,

Review of CGT Roll-overs

The Property Council welcomes the opportunity to provide comments to the Board of Taxation in relation to the Review of CGT Roll-overs (the Review) and the Consultation Guide released in February 2020 (the Consultation Guide).

The recent global outbreak of the coronavirus has had a tremendous impact on the Australian economy across virtually all major sectors, including property. We now find ourselves in uncertain times, with the effects of this significant health crisis likely to be felt for many years.

It is imperative that we set ourselves up to not only manage the short-term economic and social disruption being caused but also the medium and longer term recovery through targeted reforms in areas such as tax policy.

CGT roll-over treatment provides much needed temporary relief to taxpayers in the event of various circumstances, such as business re-organisations or involuntary asset disposals. The CGT roll-over provisions ensure that CGT is only levied at the point in time when the ultimate disposal of the asset is made. They are an important part of a fair and efficient tax system, helping our economy to remain attractive and compete globally with other jurisdictions.

A wholesale rationalisation of existing CGT roll-overs and associated provisions into a simplified set which removes the current anomalies and inconsistencies is attractive in principle. However, to ensure certainty for taxpayers (and the ATO) there would still need to be clear rules for when and how the roll-overs apply. It must also be acknowledged that such an approach could result in new issues of interpretation and create uncertainties which may take many years for regulators and industry to resolve.

As the Board has noted, challenges do exist for taxpayers in using the currently available roll-over provisions. The Review is therefore important as an opportunity to address those challenges.

We believe that, in considering a framework for CGT roll-overs, there needs to be a clear statement of the overarching principle with clear rules that address the detail of the requirements and consequences of roll-overs.

For the property industry, there are a number of existing roll-over provisions which should be amended as part of the Review to ensure that they operate as intended – in particular:

- amendments required to ensure that attribution managed investment trusts (AMITs) can access CGT roll-overs that require CGT event E4 applying to the trust (by including a reference to CGT event E10);
- Subdivision 124-Q roll-over relief for "top hatting" and the limitations imposed by the ATO in TD 2011/7;
- the ATO's interpretation of the breath of the term 'under the restructuring and the 'nothing else' requirement in the context of Division 125 (demergers) and flow on implications for other rollovers (e.g. Division 615 company interposition).

Our views are set out below as responses to the relevant Consultation Guide questions, specifically to questions 1, 3 and 4 of the Guide.

If you would like to discuss any aspect of this submission, please contact Kosta Sinelnikov on 0422 168 720 and ksinelnikov@propertycouncil.com.au, or myself on 0400 356 140 and bngo@propertycouncil.com.au.

Yours sincerely

Belinda Ngo
Executive Director, Capital Markets

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Responses to consultation questions

1. Do you agree with the policy considerations outlined in [the Consultation Guide]*? Are there any other policy considerations that should be taken into account? Why?*

We generally agree with the broad policy considerations outlined in the Consultation Guide. These considerations are premised by the fact that CGT roll-overs are available for:

- business re-organisations where there is no change in underlying ownership of the asset concerned;
- involuntary asset disposals; and
- business re-organisations that do allow for a change in the underlying ownership of the asset concerned.

Ideally, there would be a rationalisation of existing CGT roll-overs and associated provisions into a simplified set with a more comprehensive scope and coverage – that is, to remove the inconsistencies and anomalies that currently exist. There should also be a clear statement of the overriding policy principle underlying the roll-overs.

However, to provide sufficient certainty for taxpayers there will need to be clear tests set out within the rules. It must also be acknowledged that such an approach of rationalisation could result in new issues of interpretation and create uncertainties which may take many years for regulators and industry to resolve.

We note that the current suite of roll-overs is generally well understood and should form the basis for the Review. However, as discussed further below, there are gaps in the existing roll-over rules that should be filled and we would support clarification of the existing law where anomalous outcomes exist currently, or where there are issues of interpretation which limit the availability of roll-overs or result in substantial risk of ATO challenge.

Overall, the policy considerations are a good starting point for addressing the issues identified in the existing rules, but these should also be put into the context of the policy intentions behind the current rules and how they are being put into practice.

Since the introduction of roll-over provisions decades ago, regulators and taxpayers have come to take diverging views of the intention. Examples of this include views on demergers and multiple roll-overs, where taxpayers concentrate on the mechanics of the rules and maintaining same economic ownership whereas regulators view the rules through a focus on the arrangement to include other related steps or transactions.

For involuntary disposals (e.g. compulsory acquisitions), these are becoming more common with increasing urban regeneration and investment in infrastructure, but the requirements are overly legalistic rather than being practical and sensible. We suggest that the Review consider a restatement of policy intentions behind the relevant roll-overs to provide fairness, economic efficiency and simplicity of use.

3. Are there any deficiencies and limitations in the current suite of roll-overs that can be addressed by a more principles-based approach to roll-over relief?

Yes, there are gaps in the existing rules and roll-overs that should be filled.

The Property Council supports addressing a number of deficiencies and limitations in the current suite of roll-overs through legislative amendment. Some specific examples are set out below – we note that providing a more holistic and entity agnostic approach to CGT roll-overs would likely overcome some of these limitations and anomalies.

This approach best preserves the value of existing practices and authority, while ensuring consistency with the policy intentions underpinning the rules, including the principles outlined in the Consultation Guide.

Subdivision 124-M and Subdivision 126-G rollovers - AMITs and CGT event E10

There is an anomaly in the current tax legislation that prevents AMITs and their unitholders from accessing the CGT roll-over provisions for common commercial restructures, including Subdivision 124-M scrip-for-scrip roll-over and Subdivision 126-G relating to transfer of assets between certain trusts with the same beneficiaries. These CGT roll-over provisions require that CGT event E4 is capable of applying to all of the units and interests in the trust (to prevent discretionary trusts from accessing the roll-overs).

However, while CGT event E4 continues to apply for unit trusts and managed investment trusts (MITs), the equivalent CGT provision for AMITs is CGT event E10. As such, the references to CGT event E4 in the CGT rollover provisions need to be updated to also include CGT event E10. Based on our previous discussions with Treasury and the ATO, we understand that this is an anomaly in the current legislation that arose due to the lack of required consequential amendments when the AMIT rules were introduced. Importantly, there was no policy intention to prevent AMITs and their unitholders from accessing the CGT roll-over provisions.

This anomaly has also been an impediment to some MITs from electing into the AMIT regime.

We therefore recommend the introduction of a simple technical amendment to ensure the interaction between the AMIT regime and the CGT rollover rules operates as intended.

Subdivision 124-Q roll-over relief and top hatting

Subdivision 124-Q was introduced in 2007 in order to provide relief for investors in a stapled group, such as an Australian listed property trust, where there has been a restructure involving the interposition of a unit trust between the investors and the stapled entities (referred to as 'top-hatting').

As noted in the Consultation Guide, the policy rationale for that provision was:

> *To enhance the international competitiveness of Australian property trusts and facilitate their expansion into offshore markets. Stapled groups have become increasingly dependent on the acquisition of overseas assets in order to increase their competitive position.*

The state and territory governments subsequently introduced stamp duty relief to facilitate top-hatting restructures.

However, in April 2011 the ATO issued Tax Determination TD 2011/7 which introduced significant risk in reliance on Subdivision 124-Q roll-over, such that very few groups have

actually implemented top-hatting restructures, even though such restructuring may promote economic efficiencies and simplification, including administrative and compliance cost savings for investors.

TD 2011/7 formalised the ATO's view that a unit trust that is interposed between investors and the stapled entities (typically a company and one or more trusts) would be deemed a trading trust if the trustee of the unit trust later gains control (or the ability to control), either directly or indirectly, of the operations of an entity that are in respect of a trading business. That is, an interposed trust would become subject to tax in a similar way to a company where the subsidiary company established a new subsidiary carrying on a trading business. This imposes an unacceptable ongoing restriction on normal business operations where Subdivision 124-Q roll-over has been applied in respect of a restructure.

The interpretation in TD 2011/7 has resulted in very few groups undertaking 'top-hatting' restructures despite the clear policy intent that sits behind Subdivision 124-Q roll-over relief.

We believe that the Board of Taxation should recommend clarification of Subdivision 124-Q, allowing this provision to operate as intended and within the scope of the original policy rationale behind the provision.

Division 125 and Division 615 – Interpretation of 'nothing else' requirement

The ATO's interpretation of the breadth of the term 'under the restructuring' and the 'nothing else' requirement (referred to in Draft Tax Determination TD 2019/D1) in the context of Division 125 roll-over relief for demergers has created significant uncertainty for taxpayers.

The ATO's interpretation limits the operation of Division 125 to make it more restrictive than was the case based on how the roll-over had previously been interpreted by the ATO. The appropriate scope of Division 125 should be considered as part of the Review together with legislative amendments that may be required to ensure that Division 125 operates as intended.

To qualify for Division 125 demerger relief a number of requirements must be met. One of those requirements is that, 'under the restructuring', the holders of original interests in the head entity must receive new interests in the demerged entity and 'nothing else'. Hence, a demerger will generally not qualify if the shareholders in the head entity receive cash, shares (other than shares in the demerged entity) or other consideration under the demerger.

In TD 2019/D1, the ATO takes a broad view of what constitutes an event 'under the restructuring' and a strict view on what will breach the 'nothing else' requirement, with the result that many transactions that involve a demerger followed by a sale of the shares in the head company of the demerger group will not benefit from Division 125 roll-over relief for the demerger, even where the demerger is not dependent on the sale transaction being approved by shareholders. While the ATO had not previously issued a public ruling of general application dealing with these aspects of Division 125, the interpretation in TD 2019/D1 is clearly contrary to a number of class rulings issued by the ATO over a long period prior.

Division 615 roll-over (interposing a company above a company or trust) also has a 'nothing else' requirement.

We consider that both Division 125 roll-over and Division 615 roll-over should remain available in situations involving a subsequent transaction, as this best achieves the objectives of achieving economic efficiency and value creation.

The Review should consider whether the restrictions resulting from the ATO's interpretation in TD 2019/D1 are consistent with the policy objectives of Division 125 and Division 615, and consider legislative amendments that would clarify the scope of these roll-overs in order to meet the underlying policy objectives.

4. Can the system benefit from any additional categories of roll-overs? To what extent would any additional roll-over category encourage the active use of assets in the economy and maintain the integrity of the system generally?

Yes, we believe that the system would benefit if it provided comprehensive CGT roll-overs that were entity agnostic. This applies especially in the context of roll-overs where there is no change in the underlying economic ownership. We believe that there should be broad CGT roll-overs that apply in all such circumstances, rather than the fragmented approach that currently exists.

For example, a number of gaps exist in the current suite of roll-over rules relating to business re-organisations where no change occurs in the underlying ownership of the asset. We consider that the following situations should be considered as part of the Review:

- Interposition of a trust above a trust or company (scrip-for-scrip roll-over can achieve this for a trust but not for a company) – that is, effectively extending Division 615 roll-over to trust interpositions.
- Transfer of assets between wholly owned trusts. As trusts are generally not able to form a tax consolidated group, wholly owned group roll-overs should be available – for example through expanding Subdivision 126-B to apply to domestic and foreign trusts.
- Similarly, the Subdivision124-M scrip-for-scrip roll-over provisions are unnecessarily narrow and should be more flexible to facilitate business restructures. For example, currently the rules require that the trust purchaser must be the issuing entity. However, this is not a requirement for companies in wholly owned groups. This should be rectified based on an 'entity agnostic' approach to allow for similar relief for both companies and trusts.

We would welcome the opportunity to provide additional submissions in relation to detailed drafting considerations in respect of the above.