Australian Government

The Board of Taxation

REVIEW OF CGT ROLL-OVERS

Consultation Paper

the board of taxation

www.taxboard.gov.au

December 2020

CONTENTS

CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

Providing a confidential response

All information (including name) contained in formal submissions will be made available to the public on the Board of Taxation website, unless it is indicated that you would like all (or part) of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked in a separate document.

A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Next steps

The feedback obtained through this process may inform the Board's advice to the Government on the approach to take in reforming capital gains tax roll-overs. Once the public submission process is concluded, further targeted consultation may be necessary to clarify any issues or questions which arise from submissions.

Stakeholders are invited to provide early feedback by way of an informal email on key issues as early as possible in the consultation period, followed by a formal submission by the deadline. This will enable the Secretariat the necessary time to consider important issues.

CLOSING DATE FOR SUBMISSIONS: FRIDAY 5 FEBRUARY 2021

Email:	cgtrollovers@taxboard.gov.au
Mail:	Board of Taxation Secretariat The Treasury Langton Crescent PARKES ACT 2600
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INDEX OF CONSULTATION QUESTIONS

The Board would appreciate submissions on any of the following consultation questions and other relevant issues. You should not feel obliged to address all of these questions and we encourage you to raise any other issues that you consider relevant.

3.2 Why a general restructure roll-over?

1. Do you agree with this articulation of the benefits of a comprehensive, general restructure roll-over? Please provide examples to illustrate these benefits.

2. Are there other advantages in addition to those discussed above?

3. Should the general restructure roll-over be expanded to incorporate the functions of any other existing restructure roll-over? If so, please explain your rationale and provide details (and examples) as to how they can be incorporated.

3.3 Designing the general restructure roll-over?

4. Would the proposed approach outlined in Step 1 to define the relevant ‘business restructure’ provide greater certainty than the current regime? What other alternative approaches should the Board have regard to?

5. Does the features allowing specific CGT events to be excluded from the ‘eligible restructure’ give rise to any integrity concerns or other practical difficulties?

6. Do you have any suggestions relating to the roll-over election rules? Are they practical and could the requirements be further simplified? If so, how?

7. Do you agree with limiting the eligible restructure period to 12 months? If not, please explain your rationale and identify any alternate approaches.

8. How could the eligibility conditions be improved or simplified? Where your recommendation contracts or expands the eligibility of transactions for roll-over relief, please suggest how this may be balanced given the terms of the Board’s review provide that any reforms should have ‘a substantially similar practical effect’.

9. Where the restructure involves only publicly listed groups, what modifications should be made to further streamline the eligibility conditions? For example, where certain integrity provisions are not relevant or are commercially impractical to apply.

10. Do you consider that the adoption of a single 'push-up' cost base rule for the acquiring entity would deliver simplification advantages?

11. Does it represent a reasonable trade-off in light of the other benefits of a general roll-over?

12. If preserved, how could the existing market value 'step up' be incorporated into the general roll-over without importing excessive complexity?

13. Do you agree with the other proposed consequences for the general roll-over?

14. Are there any practical difficulties associated with these consequences? We would appreciate your submissions on potential solutions to these issues.

15. Currently, partial roll-over is a feature of Subdivision 124-M and to a limited extent in Subdivisions 122-A and 122-B but not Divisions 125, 615 and Subdivision 126-B.

    a. Given that introducing partial roll-over to the general model will increase its complexity, to what extent (if any) should partial roll-over be available under the general model?

    b. Please provide examples of transactions which would not occur without partial roll-over?

16. Paragraphs 1(d) and 5 of the Model Demonstration provides a definition for original and replacement assets. Are there any difficulties with classifying assets into these two categories? Please include examples to illustrate your answer where possible.

17. It is important that the benefits of the preliminary roll-over model are also well understood. Compared to the current suite of roll-overs, what are the key simplifying features that would provide the most value in a general restructure roll-over? What other features of the preliminary roll-over model provide important benefits?

5.1 Broad Policy Issues

18. What constraints should be put in place on the availability of roll-over where a capital raising has occurred? Should any subset of transactions be excluded from these constraints, for example, public companies that are subject to strict regulatory control?

19. In what circumstances do capital raisings give rise to integrity concerns such as inappropriate value shifting? How could these concerns be addressed?

20. Should the cost base of replacement interests be adjusted to reflect any dilutionary effect of a capital raising?

21. Are there scenarios apart from demergers where it would be appropriate for roll-over to be available for a reorganisation that includes a capital raising component?

22. Are any ongoing impacts of COVID-19 expected to change the nature of future capital market and demerger transactions?

23. Would you support a general rule that assets received by way of replacement for pre-CGT assets will be taken to be post-CGT assets with a market cost base? Why? Why not?

24. Can you suggest ways for dealing with pre-CGT assets under the general roll-over that that would provide maximum simplicity?

25. Would extending general roll-over to trusts that satisfy CGT event E4 or E10 make relief practically available to AMITs? What additional obstacles, if any, would prevent relief being accessed?

26. For what types of arrangements would AMITs contemplate using general roll-over?

27. Would giving AMITs access to general roll-over be inconsistent with the requirement for an irrevocable decision to enter the AMIT regime? How could this concern be addressed?

28. What implementation issues should be taken into account in extending relief in this way?
29. Are there any integrity issues that the Board should have regard to in extending this treatment to merger and takeover transactions?
30. What integrity issues or practical difficulties should the Board give further consideration to in removing the like-for-like requirement?
31. What implementation issues should be taken into account in extending relief in this way?
32. Are there any integrity issues that the Board should have regard to in extending this treatment to merger and takeover transactions?
33. Would there to be demand from the small business sector to use the general business roll-over given the availability of alternative methods of reducing or eliminating tax liabilities?
34. Would you support reforms to establish more clearly defined functions for Division 152 and the SBRR?

STATEMENT FROM THE CHAIR

The Board of Taxation is pleased to present this Consultation Paper as part of the next key phase of its review of capital gains tax (CGT) roll-overs.

It is clear from our consultations that a well-designed system of roll-overs is a vital component of the capital gains tax regime. Roll-overs ensure that CGT is fair, efficient and simple.

Thirty-five years after the introduction of CGT, and more than twenty years after the enactment of the current legislative framework, it is timely to stand back and review this key design feature of CGT as a whole and bring about meaningful and lasting improvements to the system.

This consultation paper has been prepared with two key objectives in mind.

- The first is to present a framework of principles for CGT roll-overs to help develop a shared understanding of what roll-overs are for and the role they play in the CGT framework and the tax system more broadly.
- The second is to present a general roll-over for business restructuring.

Business restructuring is a natural focus area for the Board and has featured in a number of recent Board reviews. Having the right structure is critical to business success. And as recent events have shown, businesses at times need to adapt to radically changing circumstances. What constitutes the right structure is not static but can change over time. It is, therefore, critical to ensure that the tax system is not an unreasonable impediment to commercially driven structuring decisions. It is also important that the tax system remains fit for purpose, provides certainty and does not impose unnecessary red tape and compliance burdens.

The aim of the general roll-over is to replace the existing suite of transaction-based restructure roll-overs with a single, principles-based relief that provides clear and consistent outcomes. The general roll-over is designed to be simple, comprehensive, and aligned with commercial practices while preserving the important integrity function of CGT.

In our consultations, stakeholders have highlighted the irritants and complexities that exist when applying the current suite of CGT roll-overs and these concerns are legitimate. Through the general roll-over, we are proposing to respond to these issues in a systemic, rather than an incremental or piecemeal, way. This is undoubtedly a challenging task, and your contribution will be vital to its success.

OVERVIEW

What this paper is about

This Consultation Paper represents an important phase in the Board's review of CGT roll-overs. It focusses on the application role that roll-overs play in facilitating business restructures. `

The Terms of Reference for the review invite the Board to 'rationalise the existing CGT roll-overs and associated provisions into a simplified set that have a substantially similar practical effect, but are easier to use and interpret'. While reducing red tape has been a longstanding aim of policy-makers, it has recently taken on greater urgency in the context of the Government's revised economic strategy for Australia's recovery. There is now a window of opportunity to address issues in a holistic way – making them simpler, more accessible and addressing the irritants that stakeholders have alerted us to in our consultations. Reforms to business restructure roll-overs are particularly timely as many businesses face the prospect of needing to restructure to adapt to a post-COVID future.

Rationalising and simplifying CGT roll-overs is not merely a matter of rewriting the existing law without disrupting the status quo. It involves confronting some quite fundamental questions about the role that roll-overs should play in a mature business tax system, when relief should be available and to whom, and how it should be designed.

This process has helped us identify some opportunities not only for making the system simpler, but also for better aligning it to the commercial drivers of restructuring as well as addressing irritants in the current system. Necessarily, achieving these goals in a way that is sustainable and preserves the integrity of the tax system, requires users to accept certain trade-offs.

With these objectives in mind, this Paper is set out in five parts.

- **Part one** details the policy history of roll-overs and their evolving function within the broader tax system.
- **Part two** suggests a principled framework that could be used to guide future reform processes.
- **Part three** outlines a model for a general business restructure roll-over that would combine and replace a range of existing roll-over provisions.
- **Part four** provides a demonstration of the model in a format that is familiar to users of the system.
- **Part five** discusses important policy issues that arise in the course of synthesising the current suite of roll-overs. It outlines opportunities for extending the availability of relief and suggests reasonable trade-offs.

Throughout the document, we have posed a number of focus questions seeking your input on how our proposed model could be further refined. You should not feel obliged to address all of these questions and we encourage you to raise any other issues that you consider relevant.

The Board believes that implementation of a general business roll-over could be a most timely reform as we contemplate the post-COVID future. It will make a meaningful contribution to the Government's agenda of reducing red tape in the tax system and help create a more stable platform for a business-led recovery.

The adoption of a general business roll-over would also be an important first step in a broader reform process. In the subsequent phase of this review, the Board will use its principled roll-over framework to assess the merits of extending the general business restructure roll-over in application to transactions not covered by existing reliefs.

1 BACKGROUND

1.1 Roll-overs in context

Critical to understanding the policy basis of roll-overs is to have an appreciation for the role of CGT in the overall tax system.

As a key plank of the base-broadening tax reforms of the 1980's, CGT moved Australia's income tax system closer towards a comprehensive tax base. Its adoption reflects the economic notion of income, which includes the change in value of assets in addition to the regular cash flow they generate. Individuals or businesses that hold an appreciating asset have an increased ability to consume or invest in other assets and, therefore, an increased ability to pay tax.

The primary goal of CGT, therefore, was to foster greater fairness and equity in the tax system. It ensures a level playing field between those earning ordinary income and those making capital gains, whether directly as individuals or through business entities in which investment in assets may be made or managed. The Asprey Committee put forward the case in 1975, paving the way for the key reform a decade later:

> *The Fundamental argument here is that in a taxation system in which ability to pay is a primary test of liability, capital gains, whether accrued or realised, constitute an increase in ability to pay in so much the same way as receipts of wages, salaries, interest and rents as to make it inequitable for them not to be brought to tax. Failure to tax them gives rise to inequity of both the kinds earlier distinguished:*
>
> > *(a)* ***Horizontal inequity*** *occurs because individuals in similar circumstances are treated unequally in that those who derive their accretions to market power in the form of non-taxable gains pay less tax than those deriving more conventional income.*
> >
> > *(b)* ***Vertical inequity*** *occurs between individuals in dissimilar economic circumstances in that the failure to tax capital gains will usually favour those who are more well-to-do rather than those who are less, since the former own more capital per head than the latter and are more likely to make investments that realise capital gains.*[1] *(emphasis added)*

The other policy goal driving CGT's introduction was economic growth; specifically to enhance the efficiency of our economy by reducing the undue influence that the tax-preferred status of capital gains was having on investment decisions. The then Treasurer noted in his Second Reading Speech:

> *The lack of a capital gains tax has also distorted investment choices towards less productive uses. Decisions to invest have been determined, not only by the overall yield of a project, but also by the composition of that yield as between tax-free capital gains and assessable income. This has produced an inappropriate pattern of investment, preventing Australia from achieving the best possible economic growth rate. Australia is a capital scarce nation – the last thing it should be doing is providing incorrect signals to the market as to how to allocate that capital.* [2]

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[1] Asprey, K. (1975), *Taxation Review Committee; Full Report*, Canberra: AGPS (January), paragraph 23.12.

[2] Commonwealth, *Parliamentary Debates,* House of Representatives, 22 May 1986, 3801 (Paul Keating, Treasurer).

1.2 The fundamental design compromise necessitating roll-over relief

A fundamental design feature of CGT is its *realisation basis* for bringing capital gains to tax. This feature represents an intentional departure from the comprehensive tax base, which, in theory, would require the taxation of economic gains and losses in the same annual income period that has been adopted for taxing ordinary income. There are obvious practical reasons why this compromise has been made. First, regular market valuations of investment in assets for tax purposes would impose unreasonable costs on taxpayers and, secondly, liquidity constraints arise for taxpayers in paying tax on assets not actually realised.

The realisation basis design is responsible, however, for introducing a different set of investment distortions. Most relevantly, the deferral of the taxing point until asset disposal operates as an incentive for businesses to hold onto those assets longer than they otherwise would in the absence of tax considerations (the so-called 'lock-in effect'). If economic gains were subject to tax as they accrued, businesses would base their investment decisions on where their resources generate the highest rate of return and not be locked into their existing position.

In acknowledgement of this detrimental impact of the so-called lock-in effect on efficient business activity, whereby assets are retained to avoid realisation, roll-over relief was included as a key design feature of CGT on introduction to allow for the deferral of capital gains in certain situations.

1.3 Brief historical overview to roll-over policy

The history relating to roll-over relief provides important guidance in thinking systemically about its role in the system. It gives credence to the idea that tax design is as much art as it is science. Striking the right balance between often competing tax policy objectives is a difficult exercise and requires value judgements to be made. And in the case of CGT and roll-over relief, it is clear that consensus has been somewhat elusive.

As noted above, the view that held sway in implementing reform in the 1980's was that far greater distortions in investment and commercial decisions occurred in the absence of CGT than with it. The then Government was unequivocal that '*by ameliorating th[ese] distortion[s], the capital gains tax will help to improve the overall productiveness with which capital is invested in Australia, improving our international competitiveness and lifting our economic growth rate*.'[3] Between the announcement of CGT in September 1985 and its implementation in May 1986, the Government carefully deliberated on the extent of roll-over relief to be provided.[4]

By placing a strong emphasis on the equity and integrity benefits CGT delivered, the Government ultimately granted very limited relief in strict circumstances for businesses reorganising the ownership of assets, justifying it only for '*certain situations where no change occurs in the underlying ownership of the asset concerned, or where the underlying assets against which the taxpayer has a claim do not change.'*[5] It

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[3] Ibid.

[4] In fact, the then Government's initial disposition was to implement a CGT without any roll-over relief on the basis of the inequities and complexity that would result. See Draft White Paper, *Reform of the Australian Tax System,* Canberra 1985, Chapter 7.

[5] Keating, P (Treasurer) 1986, *Capital Gains Tax: Further Information,* Media Release No.24, 20 March, Canberra.

implemented CGT with a number of specified roll-overs and indicated that it would consider additional relief as further circumstances arose.

At the time, arguments were made in favour of more widely available relief for business reorganisations so as not to inhibit desirable business behaviour. In rejecting this argument, the then Government emphasised the equity objective of CGT and expressly noted the policy intention for business entities to be subject to CGT,[6] regardless of the economically significant capital allocation decisions businesses make.

Specifically contemplated as part of the initial CGT package was roll-over for mergers and takeovers.[7] Initially, the decision was taken not to extend relief for such transactions on the basis that they represented a major change in the underlying ownership of assets. That is, the interest in assets represented by shares held by shareholders of one company after the merger or takeover would be considerably different to the interest in assets represented by the shares that they held prior to the merger or takeover.

However, reflective of the long-held debate as to whether CGT leads to reduced or enhanced economic efficiency,[8] the ascendant view in government by 1999 was that the lock-in effect was too distortive on investment decisions and harm Australia's international competitiveness. The most notable policy change to address it was the advent of the 50 per cent CGT discount, which sought to '*enliven and invigorate asset management, to stimulate greater participation by individuals in investment, and to achieve a better allocation of the nation's capital resources*'.[9] The discount counters, to an extent, concerns that the realisation model, which taxes accumulated gains in the year of disposal, pushes individuals into a higher marginal tax bracket by lowering the effective tax rate.

A similar policy underpins the so-called scrip-for-scrip roll-over in Subdivision 124-M,[10] effectively reversing the position of 1986. A CGT taxing point on the exchange of shares in a corporate merger or acquisition posed liquidity problems for some individual equity holders, who therefore required a compensatory premium. The judgement was made that, notwithstanding a change in ownership of the assets represented by shares, the Australian economy would be better off overall if the dead weight of CGT was removed to free up the capital market and generate greater corporate acquisition activity. That judgment was made in response to a recommendation from the 1999 in-depth *Review of Business Taxation, A Tax System Redesigned,* itself perhaps swayed by the empirical analysis commissioned and put forward by the Securities Institute of Australia regarding the net benefit to the economy over time.[11] In acknowledgement of the conjecture surrounding the merits of roll-over relief that departed from the normal rule, the *Review of Business Taxation* also recommended that a post-implementation analysis be undertaken after five years to evaluate its effectiveness in generating beneficial economic activity.

Whilst the demerger relief in Division 125 was introduced in the context of the same policy discourse as scrip for scrip (about removing liquidity constraints and enhancing the efficient functioning of the capital market),

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[6] Commonwealth, *Parliamentary Debates,* House of Representatives, 22 May 1986, 3801 (Paul Keating, Treasurer).

[7] See Attachment D to Cabinet Submission No. 3158, Australian Government, 1985.

[8] See Evans C and Australian Tax Research Foundation, *Taxing Personal Capital Gains: Operating Cost Implications,* Research No. 40, 2003.

[9] Costello, P (Treasurer) 1999, *A New Tax System*, media release, 21 September, Canberra – Attachment D: *Introducing an Internationally Competitive Capital Gains Tax System.*

[10] All legislative references in this paper are references to the *Income Tax Assessment Act 1997* unless otherwise specified.

[11] Submission No.54, Submissions to a *Platform for Consultation*, Review of Business Taxation, 13 April 1999.

notably its design adhered to the original principle of requiring maintenance of underlying economic ownership. Recent commentary has emphasised the limited commercial benefits of this relief as a result of the ATO's administrative approach to this requirement. This is further discussed in Part Five, '*The Key Policy Issues'*.

CONCLUSIONS

The background to roll-over relief articulated above tells us the following:

- Equity is a fundamental objective of CGT and granting relief from it.
- Efficiency in the context of CGT is harder to discern and policy settings have not been static over the course of CGT's existence in the Australian tax system.
- Roll-overs have been added over time in a reactive way, resulting in a body of law that is relatively unstructured, transaction-based and difficult to navigate.
- The policy rationale of the CGT discount and roll-over relief for mergers and takeovers may reflect a judgment about the taxation of capital gains at a particular time, but do not represent a rejection of the comprehensive income base as the key conceptual anchor underlying Australia's tax system, nor an endorsement of CGT-free business transactions for economic growth.

2 THE POLICY STRATEGY – A PRINCIPLED FRAMEWORK

2.1 Guiding principles for policy coherence on roll-overs

The strategy for reform in this area of taxation law is to reduce complexity and provide greater certainty and consistency in the application of roll-over relief to commercial restructuring transactions that fit within clear policy parameters.

To guide this strategy, the Board has developed policy principles to underpin roll-overs for business reorganisations.

The first application of these principles has been used to inform the central idea proposed in this paper – the general business restructure roll-over. In addition, it should be expected that these principles be used in the following way:

- to guide the Board in phase two of this review in relation to any consideration of additional roll-over relief which can be established to be beneficial for the Australia's economic recovery, and
- as an ongoing resource or 'roadmap' for the Government in thinking about roll-over relief in a systematic way.

Principle 1: There is a rebuttable presumption against roll-over relief

The equity (and to a lesser extent, efficiency) arguments in favour of taxing capital gains remain sufficiently strong as to generally outweigh removal of the CGT taxing point for business transactions. Generally, CGT should apply to tax the gain in asset value when disposed of, whether that asset is held directly, or through the various business structures in which investment in assets is made or managed.

Principle 2: Roll-over should be available to relieve inefficient asset 'lock-in' for business where there is strict continuity of economic ownership

Application of roll-over where investors have the same economic exposure to the same economic assets in the same proportion (i.e. merely the legal form of the ownership is changing) can be justified on the basis that there is continuity in the investment and, in pursuit of business efficiencies, businesses are simply rearranging the structure through which that investment is made or managed.

Principle 3: Relief for transactions involving a change in the underlying economic ownership of assets should be predicated on evidence of additional economy-wide benefits for Australia

All taxes impose costs on the economy and may prevent some economically advantageous activity from proceeding. Consistent with the intended comprehensive tax base and the main equity objective of CGT, any decision to remove the dead weight of CGT on the economy (and defer the taxing point to a later time) should be empirically tested for the additional economic activity likely to be unlocked. Consideration should also be given as to whether a CGT deferral is the most efficient way of supporting that activity. For example, industry policy is often best effected by way of direct grant funding.

Principle 4: Roll-over should not facilitate the transfer of assets to a tax-advantaged entity

Roll-over relief is designed to achieve deferral of an amount of tax that would otherwise be payable upon a disposal, not to achieve a permanent reduction or relieving of such tax. It follows that relief should generally not be available if it would have the effect that the ultimate CGT liability is transferred to a more tax-advantaged entity.

For example, roll-over relief should not be available where a transferee entity has discretion as to which member of the entity is entitled to the income or capital of the entity, such as certain trusts. This is because it is difficult to establish the real economic ownership of assets with any degree of certainty and, therefore, difficult to discern whether that ownership has continued through the roll-over transaction. Similarly, relief would not be available for the demerger of a trust by a company, as this would allow profits of the corporate group to be distributed to the ultimate shareholders in a more tax-advantaged way. A feature of the existing business roll-over framework is an apparent 'incorporation bias'. That is, roll-overs tend to encourage the adoption of a corporate form of business ownership and discourage incorporated businesses from adopting a non-corporate structure. The Board would like to better understand the rationale for this apparent bias.

Principle 5: Roll-over should defer, not eliminate, a tax liability

To the extent not already covered by principle 5, roll-over relief should not be available to facilitate transactions that result in an asset leaving the Australian tax net, such as transactions resulting in the transfer of CGT assets to a tax exempt entity or a CGT asset that is not taxable Australian property to a foreign resident. Roll-over should also not apply if giving relief would produce a permanent tax advantage because of the change in tax character of an asset (eg, from a capital asset to trading stock).

Principle 6: Transactions that would qualify for 'single entity treatment' if undertaken by members of a consolidated group should generally not receive roll-over

The introduction of the consolidation regime was accompanied by the removal of certain roll-over and other grouping concessions in the tax law. Since that time, the clear policy has been that the single entity rule is meant to operate as the exclusive code for asset transfers between consolidatable entities. In other words, members of a consolidatable group are intended to be taxable on intra-group asset transfers unless they form a consolidated group.

The general roll-over proposed in this paper preserves this principle as an exception to the principle that transactions involving no change in underlying economic ownership should be eligible for roll-over.

Some stakeholders have suggested that Principle 6 should be revisited. This is discussed in Part Five, under *Interaction with the Consolidation Regime.*

3 RATIONALISING BUSINESS RESTRUCTURE ROLL-OVERS

3.1 Overview

Set out in this part is the Board's first articulation of the opportunity to rationalise the existing suite of roll-overs.

The opportunity that stood out as having the greatest potential to reduce the regulatory burden and make roll-over relief more accessible was consolidation of roll-overs facilitating demergers, mergers and other business reorganisations into a single roll-over. Business restructure roll-overs play a vital role in the broader business tax system. They perform the function of preserving the important integrity function of CGT while removing impediments to commercial transactions that would benefit both the affected business and, ultimately, the broader economy.

The current system of business roll-overs has evolved significantly since the introduction of CGT and caters to a wide variety of restructure types. However, while the existing roll-overs undoubtedly facilitate a large volume of economic activity, there is a significant opportunity to modernise the system, to make it simpler, and to deliver more certain, consistent outcomes.

After analysing the existing roll-over framework and hearing from stakeholders, the Board decided to focus on incorporating the following roll-overs into a single general business restructure roll-over:[12]

- Subdivision 122-A
- Subdivision 122-B
- Subdivision 124-N
- Subdivision 126-B
- Division 125
- Division 615
- Subdivision 124-M

It is intended that these roll-overs will be replaced by the general business restructure roll-over.

As indicated by the questions posed in this paper, the Board seeks the community's feedback on the breadth of restructures and the way in which we have proposed to contract and expand their operation. It would be particularly useful for stakeholders to highlight the features considered most important to maintain and, conversely, which features are believed to no longer be relevant.

3.2 Why a general business restructure roll-over?

The general business roll-over aims to respond to three general areas of concern about the current system:

[12] We note that, subject to stakeholder evaluation and further refinement, it is conceivable that the model could be expanded to include other business restructure roll-overs not currently included (for example, trust reorganisations achievable under Subdivisions 126-G and 126-C).

1. it is impeding activity that would otherwise be beneficial to both the business affected and the broader economy;

2. it sometimes produces anomalous outcomes that are inconsistent with a ‘principled’ approach to business taxation; and

3. it is overly complex, uncertain and imposes an onerous compliance burden.

With these considerations in mind, the general business roll-over has been designed with the principal aim of replacing the disparate and highly transaction-based restructuring relief currently available (which requires rigid adherence to precise legal steps) with streamlined relief based on principles, that is focussed on commercial outcomes and providing consistency of tax treatment.

More specifically, the general roll-over aims to achieve the following improvements to the current regime:

- **Neutrality**: A general roll-over would reflect neutrality in the sense that arrangements that produce similar arrangements should receive the same tax treatment. This would also eliminate outcomes under the current system where roll-over provisions can open up multiple pathways for achieving the same commercial outcomes but with different *tax* treatments - for example, the different rules for working out an interposed/acquiring entity’s cost base for its acquired assets.

- **An outcomes approach:** This approach would look to the substantial effect of arrangements, rather than the precise legal steps undertaken to achieve that effect, thereby freeing up businesses to focus on how best to *commercially* achieve a desired outcome, rather than being unnecessarily burdened by having to follow prescriptive and complex technical requirements of transaction-focussed roll-over rules.

- **Eliminates incentives to engage in back-to-back roll-overs:** This approach eliminates incentives to engage in ‘back-to-back roll-overs’ to achieve outcomes not available using any one roll-over provision. In some cases, this would enable efficiencies by allowing restructures to be achieved in fewer steps. In other cases, it ensures that roll-overs are not denied when successive steps are necessary to achieve the desired restructure (provided of course that the restructure is of a type that is intended to attract relief).

- **Eliminates complex CGT discount rules:** It will replace the existing complex rules relating to the availability of the CGT discount following a restructure – for example, in the roll-over situation followed by a pre-ordained exit as found in the case of *Hart v FCT* [2019] FCFC 179.

- **Greater clarity and certainty:** It would provide greater clarity and certainty on the application of the law as it applies to *sequential arrangements*, where a roll-over is a component of wider commercial undertaking that also includes a subsequent realisation of assets or other type of profit extraction.

- **Greater flexibility of application:** It has the capacity to extend relief to depreciating assets, trading stock and other revenue assets, providing maximum flexibility for businesses to transition to a more appropriate business structure in a post COVID-19 business environment. Under the existing system, this type of relief is available, but on an inconsistent and sometimes arbitrary basis. The greater flexibility will also mean that the roll-over can accommodate innovations in the way that restructures are undertaken.

QUESTIONS

1. Do you agree with this articulation of the benefits of a comprehensive, general restructure roll-over? Please provide examples to illustrate these benefits.

2. Are there other advantages in addition to those discussed above?

3. Should the general restructure roll-over be expanded to incorporate the functions of any other existing restructure roll-over? If so, please explain your rationale and provide details (and examples) as to how they can be incorporated.

3.3 Designing the general business restructure roll-over

The Board has developed a preliminary model for a general business restructure roll-over to form a basis for stakeholder consultation and feedback.

The Board's model was designed using the broad policy principles outlined above and the following design guidelines.

1. Wherever possible, the roll-over should allow taxpayers the freedom to choose how they restructure their businesses based on commercial reasons. This is consistent with the principle of neutrality which provides that the tax system should aim to be neutral so that decisions are made on their economic merits and not for tax reasons.

2. The general roll-over should, to the extent possible, have broadly the same effect as the original roll-overs it replaces. While trade-offs and modifications may be evident in adopting a standardised framework, the collective effect of these changes on both the accessibility and roll-over consequences should be balanced.

3. The general roll-over should function as a single coherent roll-over and not as multiple distinct roll-overs located in a single division of the Act.

Consistent with these guidelines, the general roll-over relief model employs the central concept of a 'business restructure', such that determining whether roll-over is available involves comparing the state of affairs just before the reorganisation and just after it ends. The intention is that businesses will be afforded greater freedom to make commercial decisions on how they achieve the restructured outcome.

The model also adopts the key policy settings of the roll-overs it incorporates. These policy settings are discussed at length in Part Two of this paper, *The Policy Strategy: A Principled Framework*. While the model diverges on a number of secondary policy settings, it only does so where there are conflicting disparate roll-over features.

The features of the general model are discussed in greater detail below. In addition, the next section includes a model demonstration summarising the main features discussed in this section and in a format familiar to end users of the roll-over system.

The preliminary model has three core steps:

Step 1: the rules for identifying the steps or transactions that comprise the relevant 'business restructure',

Step 2: eligibility rules comprising core and secondary conditions, and

Step 3: the rules for determining the consequences of roll-over.

Step 1: Identifying the restructure

In the proposed model, a 'business restructure' is the collection of transactions which, having regard to all the facts and circumstances, constitutes the relevant commercial endeavour or undertaking. This will encompass the steps comprising the alteration to the business restructure (which could involve multiple transactions undertaken concurrently or in succession) but would also include ancillary steps to the extent that they are part of the same commercial venture. For example, a pre-ordained sale of replacement interests that follows a roll-over could form part of the restructure.

However, a transaction would not necessarily be part of a restructure scheme merely because it is enabled by, or is a consequence of, the change in the business structure. For example, independent decisions by some owners to dispose of new interests in a separated entity which is listed on a securities exchange immediately after the new interests have been acquired, would generally not be considered as part of the restructure scheme. This is the case even though the disposals are made possible by the restructuring and it is probable that such decisions will be made.

It is noted that, under the general roll-over relief model, it will be necessary to identify transactions that constitute the restructure. This may be criticised as imposing an additional compliance burden in some cases. It is considered, however, that identifying the restructure will be a straightforward exercise for most 'vanilla' or 'routine' business restructures. For more complex transactions it seeks to provide more certainty (and flexibility) around eligibility. For example, it may enable roll-over to be accessed in some cases where, under the current law, relief would not be available or where availability is unclear. This is because the restructure concept is concerned with commercial outcomes rather than the legal steps used to achieve those outcomes.

Furthermore, the model allows businesses the flexibility to select which CGT events occurring under the restructure to receive roll-over relief. Essentially, businesses are able to exclude particular CGT events (and transactions) from the 'restructure' for the purposes of applying the general roll-over.

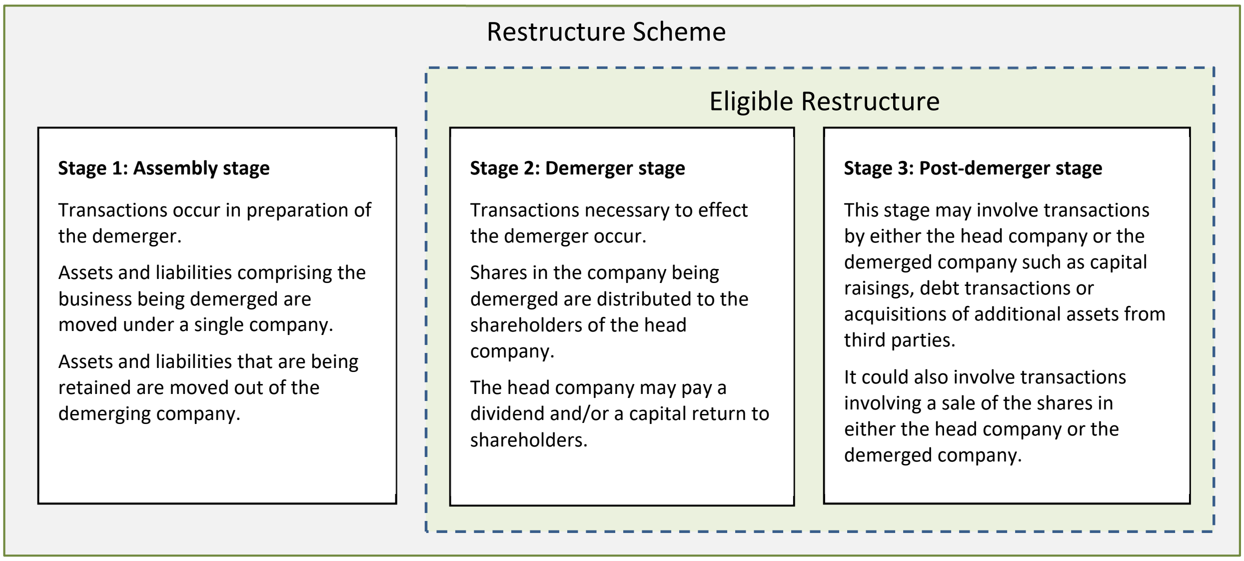
Excluding specific transactions from the restructure scheme

It is not uncommon for restructures, particularly complex multi-staged restructures, to involve numerous CGT events. In some circumstances taxpayers may wish to exclude a particular CGT event from the 'restructure' receiving general roll-over relief and to crystallise a capital gain or loss arising from the event. When a specific CGT event (and transactions directly relating to the event) are excluded from the restructure, the event (and the transactions) could be treated, for the purposes of roll-over, as not part of the restructure. This means that the CGT event:

- will not be taken into account in assessing any general roll-over conditions, and
- will not mark the start of an 'eligible restructure' period. To import greater certainty to the restructure concept, the Board is considering limiting the CGT events occurring under a restructure to those occurring within 12 months from the first CGT event eligible for the general roll-over. This idea is discussed further below.

As depicted in Figure 1, demergers are commonly carried out in three stages. There is an assembly stage, demerger stage and post-demerger stage. During the assembly stage, CGT assets may be moved between entities to ensure that only the appropriate assets sit within the demerging entity. One potential condition to general roll-over (discussed in the section on *Step 2: Eligibility Rules*) is that the restructure should not involve the transfer of CGT assets that would qualify for single entity treatment. Assuming that the head entity and demerging entity are not consolidated, transfers between them during the assembly stage may disqualify the restructure from receiving roll-over relief. However, the ability to exclude specific CGT events allows taxpayers who would otherwise be eligible for roll-over relief under the current system to continue to receive relief under the general model. The relevant entities may elect to exclude the assembly stage transactions from the 'eligible restructure' for the purposes of the roll-over. The head company would pay CGT on the gains arising from the transfers and general roll-over could be applied to the remaining stages.

Figure 1: Example of three stage demerger transaction where stage 1 is excluded from the eligible restructure



Election to apply general roll-over

The general roll-over is optional and should only defer or roll-over a capital gain or loss when an election is made by the eligible original asset holder(s). The way the relevant party prepares its income tax return would be taken as sufficient evidence of whether roll-over was chosen.

Generally, for asset-for-scrip transactions, all original owners or interest holders of the same CGT asset will be required to agree to make the roll-over election. For example, all partners in a partnership will have to agree to make the roll-over election when transferring a specific CGT asset. Where one party to the restructure does not agree to applying the roll-over, the transaction involving that party may be excluded to ensure that roll-over can apply to other transactions under the same restructure scheme.

For scrip-for-scrip transactions, each eligible original interest holder will have the option to choose whether to apply the roll-over. It should not be necessary for every original interest holder to choose roll-over as a prerequisite to it applying to the restructure. This feature will help to ensure general roll-over relief is available to transactions involving widely held entities.

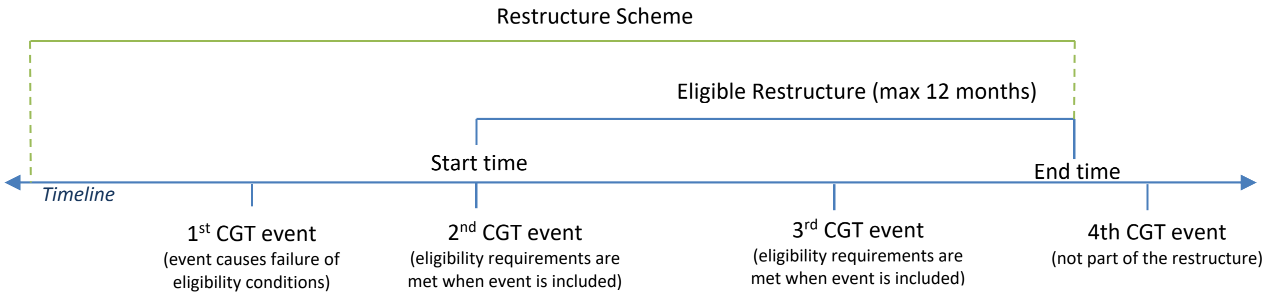
The eligible restructure period

A separate bright line test – a 12-month rule – is considered for inclusion in the model. The test is intended to provide businesses with a greater level of certainty around what CGT events may form a part of an eligible restructure. It could also ensure that business arrangements that are not genuine restructures, but perhaps investment schemes which tend to occur over a longer duration, do not receive general roll-over relief.

The 12-month rule would start at the time the first CGT event that qualifies for general roll-over relief under the restructure scheme is triggered. In theory, this start time would be relatively easy to identify and will ensure that planning activities, which may be significant for complex restructures, would not exhaust the available 12-month period.

Figure 3 below illustrates the relationship between the restructure scheme (which includes the first, second and third CGT events) and the eligible restructure (which includes only the second and third CGT events) and the 12-month bright line test.

Figure 2: Eligible restructure period



If adopted, the test could also build in flexibility to the regime. For example, it could allow exceptions for a restructure that extend beyond 12 months where there are regulatory requirements, legal disputes or other similar extenuating circumstances which prevent the restructure occurring within 12 months.

The ideas expressed in this section are summarised in paragraph 1 of the Model Demonstration and further illustrated by the examples below.

EXAMPLE 1: ROUTINE RESTRUCTURE

Mr X, a sole trader, is advised to incorporate his business so that he will have the benefit of limited liability protection and better access to bank finance. He establishes a new company to which he transfers all of the business's assets.

The restructuring period

The restructure period starts when CGT event A1 occurs (i.e. when Mr X first transfers a business asset to the new company or enters into a contract to do so) and will incorporate each transfer of a business asset that happens during the ensuing 12 months.

EXAMPLE 2: DEMERGER FOLLOWED BY CAPITAL RAISING (ADAPTED FROM TD 2020/6)

Head Co is a listed public company that conducts a hardware business directly, and an unrelated business through its wholly owned subsidiary, Sub Co. Head Co's board of directors has decided to demerge Sub Co. The restructure is expected to allow Head Co to focus on its core business operations and to increase market capitalisation by allowing the individual businesses to be valued more precisely.

Sub Co does not have sufficient operating profits or adequate cash flows from its operations to fund its business. To ensure that Sub Co will able to stand on its own after the demerger, Head Co negotiates with an unrelated third party, Acquire Co, to acquire a half stake in Sub Co under a capital raising on arm's length terms and conditions.

Steps:

1. There is an *in specie* distribution of shares in Sub Co to Head Co shareholders. This results in each shareholder owning shares in Sub Co in the same proportion that they hold shares in Head Co.

2. Acquirer Co is issued new shares in Sub Co at market value resulting in Acquirer Co owning 50 per cent of Sub Co.

The restructuring period

CGT event G1 happens to the shares in Head Co when Sub Co shares are issued to the shareholders of Head Co. This is the start of the restructure period which includes the capital raising. The capital raising forms an integral part of the commercial arrangement for restructuring the group.

Figure A: Just before the restructure

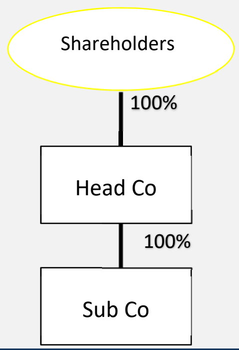
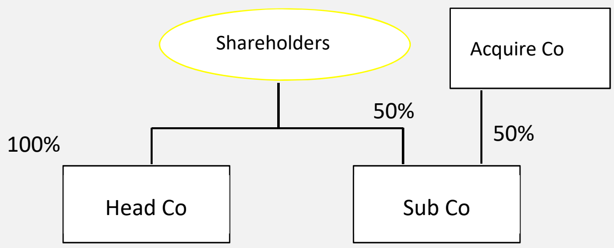


Figure B: Just after the restructure



EXAMPLE 3: MERGER OF TWO BUSINESSES FOLLOWED BY PRE-ORDAINED SALE

Jack Co and Jill Unit Trust, each run similar retail businesses.

Both Jack Co and Jill Unit Trust have two equal owners. Jack Co is owned by Smith Trust and Jack. While Jill and Smith Trust are beneficiaries of Jill Unit Trust.

To take advantage of economies of scale and other synergies of running the businesses jointly, the owners of Jack Co and Jill Unit Trust agree to merge. News of the planned merger attracts the interest of Acquire Co and after some negotiation, all parties agree to the following arrangement.

Steps:

1. A new company, Sale Co, is established.
2. The ownership interests in Jack Co and Jill Unit Trust are transferred to Sales Co in return for shares in Sales Co. Shareholdings in Sales Co are based on the market value of interests of the original interest holders.
3. All the ownership interests in Sales Co are acquired by Acquire Co in return for Acquire Co shares.

The restructuring period:

CGT event A1 happens when the ownership interest in Jack Co and Jill Unit Trust are transferred to Sales Co. The time of the first A1 event will mark the start of the restructuring period which includes the scrip-for-scrip merger of Sale Co by Acquirer Co.

Figure A: Just before the restructure

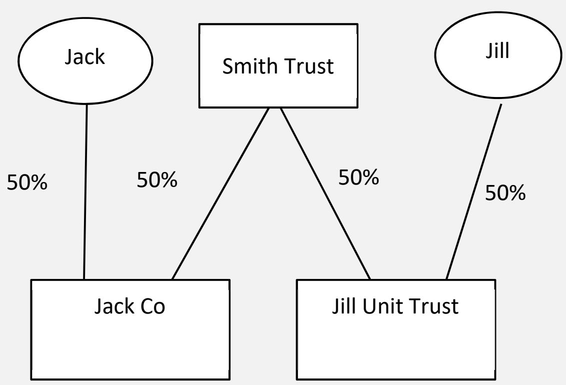
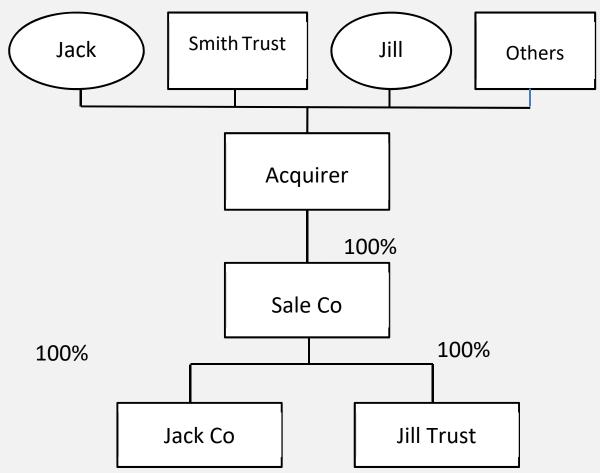


Figure B: Just after sale to Acquirer



QUESTIONS

4. Would the proposed approach outlined in Step 1 to define the relevant 'business restructure' provide greater certainty than the current regime? What other alternative approaches should the Board have regard to?

5. Does the features allowing specific CGT events to be excluded from the 'eligible restructure' give rise to any integrity concerns or other practical difficulties?

6. Do you have any suggestions relating to the roll-over election rules? Are they practical and could the requirements be further simplified? If so, how?

7. Do you agree with limiting the eligible restructure period to 12 months? If not, please explain your rationale and identify any alternate approaches.

Step 2: Eligibility rules

The general restructure roll-over model presently incorporates and replaces two broad categories of roll-overs.

- **Underlying assets-for-scrip:** Roll-overs that apply when business assets are transferred to a company and the underlying ownership of the assets are maintained. Roll-overs in this category include Subdivisions 122-A, 122-B, 124-N and 126-B.

- **Scrip-for-scrip:** Roll-overs that apply when scrip is exchanged for scrip resulting in new legal owner(s) holding at least 80% of an entity. The economic ownership of the underlying assets may not need to be maintained in certain circumstances. Roll-overs in this category include Divisions 125, 615 and Subdivision 124-M.

According to the Board's design guidelines, the general roll-over should attempt to preserve these distinct characteristics unless they are no longer relevant and appropriate in the current business environment.

Limitations on exchanges and replacement assets

To approximate the distinct limitations imposed on these two categories of roll-over, general roll-over relief could be limited to exchanges where the replacement assets are shares in a company unless the transactions involve the disposal of ownership interests that collectively represent at least an 80 percent ownership interest in an entity whereupon the replacement asset may be either interests in a company or unit trust.

This design option maintains the 80 percent demerger threshold of Division 125. However, it would also result in an expansion of roll-over relief to the interposition of a holding trust while correspondingly, contracting the availability of roll-over to some mergers. That is, relief would not be available where an entity 'becomes the owner' of 80 percent of the target (when pre-existing holdings are taken into account) but does not acquire 80 percent under the restructure scheme. The Board seeks Stakeholders' feedback on the breadth of restructures that would be affected by these contractions and expansions and how the model could be improved.

Relative to other roll-overs incorporated into the general model, the scrip-for-scrip roll-over in Subdivision 124-M contains very different and complex features. However, preliminary feedback suggests that including scrip-for-scrip in the general roll-over model is important in delivering meaningful reform. The potential compromise described above highlights the challenges of developing a general restructure roll-over and suggests one way of incorporating Subdivision 124-M without importing complexity.

It is noted that another unique condition of Subdivision 124-M roll-over is the so-called 'like-for-like' requirement, where shares must be exchanged for shares and units exchanged for units. This restriction has also not been imported into the preliminary model presented in this paper and is discussed further in Part Five under, *Removal of Like-for-Like Requirement*.

The limitations on replacement assets are expressed in Part Four, *Demonstration of Model* at paragraph 2.

Maintenance of ownership

General roll-over relief should be provided when the underlying ownership of original assets before the eligible restructure matches the underlying ownership of the assets just after the eligible restructure. Where ownership is maintained at these two 'test points', the model's maintenance of ownership requirement will be satisfied. The preliminary model does not require an examination of the individual transactions that make up the restructure. This potential feature of the general restructure roll-over may reduce the compliance costs of applying a maintenance of ownership test to many multi-stage restructures while providing more flexibilities for businesses to design restructures less impeded by prescriptive tax rules.

In working out whether the underlying ownership is maintained, it may be appropriate to disregard certain types of ownership interests. For example, interests held under employee share schemes and adjusting instruments analogous to those described in section 125-75 and *de minimis* holdings similar to those outlined in section 615-25. Additionally, the Board perceives potential merit in disregarding the effects of subsequent capital raisings on the maintenance of ownership. This issue is explored further in Part Five, under *Relief for Demergers Done in Conjunction with Capital Raisings*.

A further exception to the general maintenance of ownership rule could be imported into the general restructure roll-over to provide relief for cases currently receiving roll-over under Subdivision 124-M. Where the eligible restructure involves a merger scrip-for-scrip transaction that results in the acquiring entity owning 80% or more of the target entity, the general roll-over relief could still be provided even if the underlying economic ownership of the original assets have not been maintained.

As an integrity measure to prevent value shifting between owners of the target entity,[13] it may be appropriate to import a condition from Subdivision 124-M to require that all owners be able to participate in the merger on substantially the same terms.

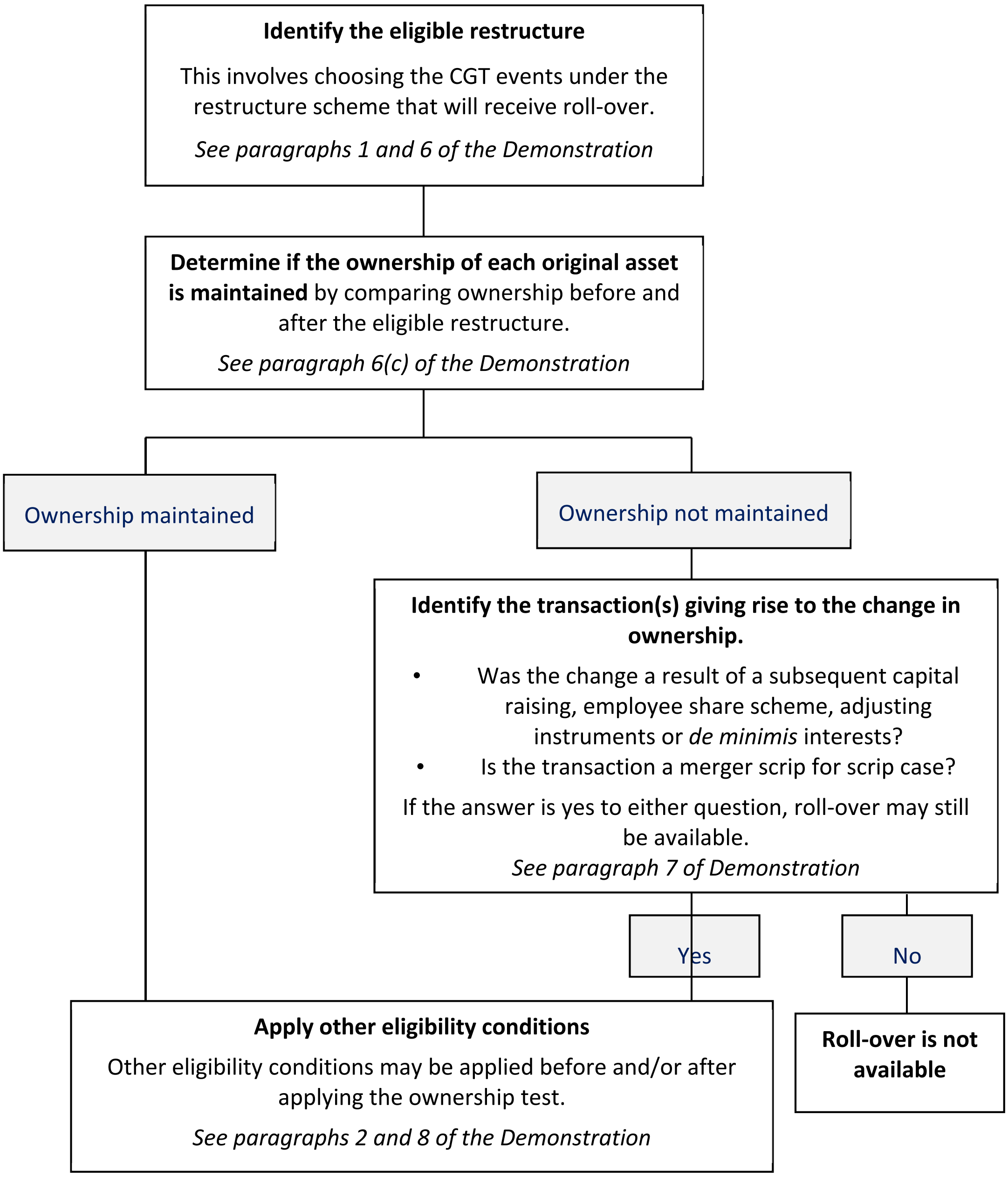
In accordance with suggestions made to the Board during its initial consultations, an exception could also be made for employees who have acquired interests through an employee share scheme. The exemption would allow roll-over to be provided while employee share schemes continue to operate unaffected to incentivise key staff during what could be seen as a disruptive period for many employees.

As discussed, the first application of the maintenance of ownership requirement ignores the internal steps of the restructure. However, to apply the exceptions described above, it may be necessary to look inside the restructure 'black box'. That is, the specific step (e.g. takeover) in the restructure which causes changes in ultimate economic ownership may need to be identified in order to determine whether an exception for specific ownership interests or the merger scrip-for-scrip exclusion applies.

These ideas are expressed in the flow chart below and in the Model Demonstration at Part 4 of this paper.

[13] For an example, see the case of *FCT v Fabig* 2013 ATC 20-413.

Figure 2: Flowchart of general restructure roll-over conditions



Potential eligibility conditions to import foundation roll-over principles

Eligibility conditions have been included to incorporate the foundation roll-over principles discussed in Part Two, *Roll-over Principles Framework,* into the general roll-over.

To ensure that the roll-over only defers and does not eliminate a CGT liability (Principle 5), the preliminary model proposes excluding eligibility where the final recipient (that is, the owner just after the restructure) is a tax exempt entity, or a foreign resident unless the replacement asset is taxable Australian property immediately after the restructure.

During initial consultations, questions were raised regarding the continued relevance of Principle 6 – transactions that would qualify for 'single entity treatment' if undertaken by members of a consolidated group should generally not receive roll-over relief. This is discussed further in Part Five, under *Interaction with the Consolidation Regime*. Should further investigation confirm the continued relevance of Principle 6, a condition could be included in the preliminary model to exclude transactions between members of a consolidatable group from receiving roll-over. Allowances could be made to ensure relief would continue to be available where assets are transferred from a trust or partnership to a company and where the transaction effects the interposition of a holding company. These transactions can potentially involve transfers between consolidatable group members but regardless, roll-over would available under existing roll-over provisions.

These potential conditions are expressed in Part Four Demonstration of Model at paragraph 8.

Additional integrity measures

The following conditions could be added to the model to enhance the integrity of the general restructure roll-over:

- The market value of the original asset must be substantially the same as the replacement asset (or capital proceeds where ineligible proceeds have been received). This measure is expressed in Part Four Demonstration of Model at paragraph 2(c) and is intended to prevent value shifts.

- The restructure must be carried out for a commercial purpose. This condition would ensure that restructures carried out for a dominant tax purpose or private/domestic purpose would not receive roll-over relief and is entirely consistent with the objective of the restructure roll-overs. That is, to remove tax impediments to business reorganising into more commercially effective structures. It is considered that CGT events excluded by taxpayers from the 'eligible restructure' (discussed in Step 1) should not limit the relevant circumstances that could be taken into account for the purposes of ascertaining the purpose of the restructure. The condition is expressed in Part Four Demonstration of Model at paragraph 1(e).

The Board recognises that some of the measures discussed in this paper may be less relevant to restructures involving only publicly listed groups or that are impractical for such widely held entities to apply. The Board would welcome Stakeholder feedback to identify these measures and suggestions that would safeguard the integrity of the roll-over while ensuring that conditions are relatively easy to apply.

Interaction with other specific CGT roll-overs

In contrast to the general restructure roll-over which is designed to apply to a myriad of restructuring scenarios, the current suite of CGT roll-overs is fairly specific in their application. The majority of replacement asset roll-overs apply only to the replacement of specific assets (such as Subdivision 124-C applying only to statutory licences) and while other roll-overs have no such restriction, they are also prescriptive in their application (for example, Subdivision 126-G applies to transfer of assets but only between trusts under precise circumstances).

Where a CGT event qualifies for both the general business roll-over and another specific CGT roll-over, the Board considers that as a broad rule, the specific CGT roll-over should override the general roll-over. This potential design feature of the general restructure roll-over is expressed in Part Four, *Demonstration of Model* at paragraph 8(a). Also, this design feature is consistent with the ordering of CGT events where multiple CGT events could apply to a particular arrangement. In such cases, the specific CGT event would apply in preference to the more general CGT event.

Relief would not be available under the general roll-over where a specific roll-over provision applies to a transaction or arrangement, but its conditions are not satisfied.

The tailored rules of a specific CGT roll-over should result in more precise outcomes and minimal compliance costs. A set order of application would also contribute to roll-overs providing consistent and certain outcomes to similar situations. It follows from the above that a business undertaking a restructure would generally not be able to choose between roll-over provisions. We have seen under the current system that the availability of choice tends to distort commercial decisions as to how restructures are undertaken, creates uncertainty and integrity concerns and raises the cost of compliance.

A possible exception to this principle is that small business entities (that is, businesses with aggregated annual turnover below $10 million) would be able to choose between using the proposed general business restructure roll-over and the existing small business restructure roll-over (SBRR). The SBRR is, in some senses, a concessional roll-over regime, that relaxes certain principles in recognition of the different challenges and incentives experienced by small businesses. Further, as the Board has noted previously, the SBRR has certain technical limitations that prevent its use for certain types of restructure (such as restructures involving the transfer of shares or units).[14] This possible exception seeks to allow small businesses access to the general roll-over if they choose that avenue.

Please also see the discussion on how the general business roll-over could apply to the small business sector in Part Five.

QUESTIONS

8. How could the eligibility conditions be improved or simplified? Where your recommendation contracts or expands the eligibility of transactions for roll-over relief, please suggest how this may be balanced given the terms of the Board's review provide that any reforms should have 'a substantially similar practical effect'.

9. Where the restructure involves only publicly listed groups, what modifications should be made to further streamline the eligibility conditions? For example, where certain integrity provisions are not relevant or are commercially impractical to apply.

In your responses to the above questions, please include examples to illustrate your answer where possible.

[14] Board of Taxation, *Review of Small Business Tax Concessions* (2019), chapter 7.

Step 3: Consequences of roll-over

First consequence of roll-over: capital gains and losses

An eligible restructure may consist of only a single CGT event or multiple CGT events. Where there are multiple events, the events may relate to different assets or the same asset as a result of a sequence of transactions. Regardless of the number of events and assets involved, where the eligibility conditions are satisfied, it is proposed that the gains and losses arising from every CGT event elected to form part of the eligible restructure will be disregarded.

Second consequence of roll-over: acquisition date

The proposed general restructure roll-over replaces a mix of both same asset roll-overs[15] and replacement asset roll-overs[16]; including roll-overs that cannot form a part of the unbroken chain of roll-overs for the purposes of an earlier deemed acquisition date under Item 2 of section 115-30 [1] (Subdivisions 122-A, 122-B and 124-N).

To allow existing acquisition date adjustments to continue to be available, an asset acquired under the general business restructure roll-over could be deemed, under Division 115, to have been acquired for the purposes of the CGT discount when the original asset was acquired before the roll-over.

This potential acquisition date rule will make it easier for some taxpayers to satisfy the 12-month holding rule required to access the CGT discount. The general roll-over would result in an earlier deemed acquisition date where the general roll-over replaces a sequence of replacement asset roll-overs that includes either Subdivisions 122-A, 122-B or 124-N. It may also provide an earlier deemed acquisition date where the general roll-over replaces a sequence of roll-overs that would otherwise include both same asset and replacement asset roll-overs.

The potential acquisition date rules bypass the existing complex rules that govern the acquisition date for multi-staged restructures making it easier for taxpayers involved to determine the acquisition date of relevant assets. However, it could also give rise to integrity issues where the advantage of the discount is made available to revenue assets or other assets that have not met the 12-month holding requirement. The Board would welcome suggestions to address potential integrity issues.

Third consequence of roll-over: cost base

In order to accommodate the wide variation of transactions and assets that could form a part of an eligible restructure, the preliminary model proposes three cost base rules..

Crucially, it proposes, as a provisional approach, a uniform rule for determining the cost base to the acquiring entity of ownership interests in a target entity.

As noted previously, incorporating the existing scrip for scrip roll-over for takeovers and mergers into the model is an ambitious task not without challenge. One benefit of its inclusion is to alleviate the perennial

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[15] Sections 122-70, 122-75, 122-200, 122-205 and Subdivision 126-B and 124-N.

[16] Sections 122-40 to 122-65, 122-150 to 122-195, Subdivisions 124-M and 124-N, and Divisions 125 and 615.

problem of 'running the part IVA gauntlet' with respect to back-to-back roll-over transactions.[17] However, its inclusion necessitates addressing perhaps the most significant policy disparity between the existing suite of roll-overs – the existence of a market value 'step up' for the acquiring entity of ownership interests in the target entity.

Typically, the mechanism in the law used to ensure a roll-over defers, and not exempts, tax is by way of the transfer of cost base from the original interest holder to the acquirer. This is the cost base rule that operates under the existing law and would operate in the Board's proposed model.

However, determining the acquiring entity's cost base is a more contentious issue. Under the current law, the scrip-for-scrip rules depart from general principle and provide a market value 'step up' unless specific integrity-based rules apply.

The history of the scrip-for-scrip rules suggests that the allowance of a market value cost base was essentially a practical concession. In introducing the roll-over, the then Government explicitly noted that it was yet to find a compromise solution that struck the appropriate balance between maintaining integrity whilst addressing the compliance burden associated with the transfer of cost base from original interest holders to the acquiring entity. At the time, the then Treasurer noted that a '*market value cost base is generally not appropriate given that a capital gain is not recognised in a full scrip for scrip exchange'*.[18] He acknowledged, however, that a '*cost base transfer between the original equity holders and the acquiring entity can give rise to compliance costs, especially where the target company is widely held. The cost base rules will strike an appropriate balance between the need to maintain the integrity of the scrip for scrip measures and the need to avoid unnecessary compliance costs*." This intended balance is found in the cost base transfer rules for closely-held transactions where there is a risk that shareholders could potentially direct the sale of assets at the company level.

Further cost base rules were introduced in 2015 for 'restructures' by widely-held companies to address the so-called 'top-hatting' integrity risk caused by the availability of the market value step-up. This necessitated even more rules to accommodate a 'stick' choice for consolidated groups.

At the heart of our Terms of Reference is evaluating whether a standardised, principles-based roll-over can deliver a meaningful reduction in the regulatory burden. Ideally, such a roll-over would have a uniform cost base rule at the entity level and discard the complex architecture and overlapping mechanisms that exists in the current law.

Accordingly, the model developed in this paper explores the prospect of preserving the cost base 'push up' rule, currently found in Division 615 and the restructure provision in section 124-784B of the scrip for scrip roll-over, as the uniform rule. That is, a cost base constructed by reference to the cost bases of the underlying trading assets of the target entity.

Such an approach would, in our view, reduce the regulatory burden in a significant way, remove the distortive incentive that encourages taxpayers to organise transactions in a way to take advantage of the available

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[17] Consultations highlighted that it is often essential to use another roll-over first so as to be in a commercially sensible position to access the scrip for scrip roll-over. For example, we understand that purchasers typically seek to acquire businesses indirectly via an acquisition of shares in a company that conducts the business. A small or medium-sized business run by a sole trader, as a partnership or in a trust is therefore often required to incorporate in preparation for on-sale through a scrip for scrip deal.

[18] Costello, P (Treasurer) 1999, *Capital Gains Tax Scrip for Scrip Roll-over*, Media Release No. 87, 10 December.

market value step up and, perhaps most importantly, go some way to offsetting the extension of relief in the various ways proposed in this paper.

However, we're aware that some stakeholders may consider that the abandonment of the market value cost base uplift for takeovers is an unreasonable trade-off for the simplification benefits and additional relief of the proposed general roll-over. The argument goes that not including a market value step up would result in double taxation – once at the acquiring entity level and then again at the shareholder level. Accordingly, market value uplift should be preserved as a feature of the general roll-over other than for closely-controlled transactions where there is a significant risk of abuse.

We are interested in hearing stakeholders' views as to the policy rationale for preserving a market value uplift in the general roll-over, noting that avoiding double taxation appears not to be the original rationale for allowing it.

QUESTIONS

10. Do you consider that the adoption of a single 'push-up' cost base rule for the acquiring entity would deliver simplification advantages?
11. Does it represent a reasonable trade-off in light of the other benefits of a general roll-over?
12. If preserved, how could the existing market value 'step up' be incorporated into the general roll-over without importing excessive complexity?

Provisional cost base model

The Board's proposed cost base rules summarised in the following table:

Table 1: Indicative Cost Base Rules

ROW	ASSET	FIRST ELEMENT OF THE COST BASE AFTER RESTRUCTURE
1	Original asset that is: - a post-CGT asset, and - not an ownership interest or is an ownership interest that collectively, with other ownership interests under the restructure, represents less than 80% of the interests in an entity -	The asset retains its original cost base after the restructure.
2	Original asset that is: - a post-CGT asset, and - an ownership interest or is an ownership interest that collectively, with other ownership interests under the restructure, represents 80% or more of the interests in an entity -	The cost base is broadly a function of the costs or value of the underlying assets of the entity to which the ownership interest relates. This approach is applied in section 124-784B (cost base calculation under scrip for scrip roll-over). This is broadly consists of the following steps: Step 1: Add ○ Market value of Pre-CGT assets ○ Cost base of post-CGT assets ○ 'value' for CGT assets with no cost base Step 2: Add

		○ Value of trading stock at start of year (plus adjustments) ○ Cost of live stock Step 3: Add nominal cost base of non-CGT assets. Step 4: Subtract liabilities in respect of step 1 assets. Step 5: Divide amount between membership interests.
3	Replacement asset	The cost base is a reasonable attribution of the cost base of the relevant original assets.

In straightforward cases, the relevant cost base rule should be easily determined by considering, the state of affairs just before and just after the eligible restructure. For example, when a sole trader transfers a personally held business asset (that is not an ownership interest) into a wholly owned company in exchange for shares:

- The business asset will be an original asset. The company's cost base for those assets would be the same as the sole trader's original cost base (in accordance with Row 1 of the table).

- The shares are replacement assets and the individual's collective cost base for those shares will be the same as the cost base of the business asset (in accordance with Row 3 of the table).

In the demerger scenario, where the underlying assets of a business are essentially split into two – the model could treat both the taxpayer's resulting shares in the demerged entity and their shares in the head entity of the demerger group as replacement assets. The cost base of these assets would be determined in accordance with Row 3 of the table.

In accordance with the Board's first design guideline of neutrality, the proposed cost base rules operate in the same manner regardless of how the eligible restructure occurs. Furthermore, whether a single CGT event or multiple CGT events happen to the asset under the restructure, the cost base of the asset will only require a single calculation.

The treatment of pre-CGT assets is further discussed in Part Five below.

Examples

The examples below provide an illustration of the consequences of the proposed general business restructure roll-over.

EXAMPLE 1: ROUTINE RESTRUCTURE

Mr X establishes a new company to which he transfers all of the business assets (original assets) in return for shares in the company (replacement assets). As part of this restructure, the new company is top hatted with a newly created holding company. Mr X will still be the sole underlying owner of the business assets before and after the restructure and assuming all other conditions for general roll-over are satisfied, roll-over relief will be available.

The ownership tests do not need to be applied to each transaction individually. Under the general model, where the underlying ownership of all relevant assets are maintained, the individual transactions forming part of the restructure do not need to be examined.

The original assets transferred will retain their original cost bases after the restructure.

The cost base of the replacement shares will be determined using the push up rule in Row 2 of Table 1.

EXAMPLE 2: BACK-TO-BACK MERGER – PUBLIC ENTITY

Head Co is a listed public company.

Head Co and its wholly owned subsidiary, Sub Co are members of an Australian tax consolidated group.

A resident company, Acquire Co, seeks to acquire the Head Co's business, however, it does not want to acquire Head Co's unrelated real property assets.

The shareholders of Head Co include residents and non-residents for tax purposes (the non-resident shareholders hold non-portfolio interests in Head Co).

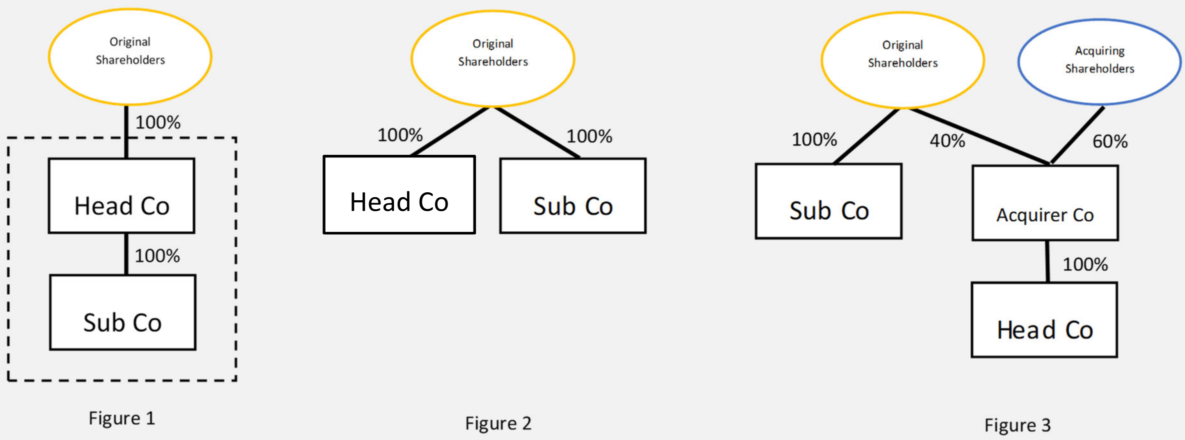
Acquire Co is a resident company in the same industry as Head Co and wants to merge to create economies of scale.

Steps:

The scheme is conditional on all steps being approved.

1) Acquirer Co approaches with a takeover bid for Head Co.
2) A scheme of arrangement is proposed under which:
    a. Head Co will transfer all of its real property assets to Sub Co. (Figure 1)
    b. Sub Co will be demerged by reducing the share capital of Head Co (CGT event G1) and compulsorily applying it to pay for the issue of new shares in Sub Co, instead of an assessable dividend being paid to the shareholders. (Figure 2)
    c. Under the demerger, shareholders will receive one Sub Co share for every five Head Co shares they owned on the date of the demerger.
    d. Head Co will advise its shareholders to apportion 90% of the total cost base to Head Co shares and 10% to Sub Co shares. This is because Sub Co represents 10% of the market value of the group as a whole.
    e. The shareholders receive new shares in Sub Co. Head Co now holds only non-real property assets and Sub Co holds real property assets. (Figure 2)
    f. A Subdivision 124-M scrip-for-scrip transaction is proposed for Head Co, with shares in Acquirer Co (Figure 3).
    g. Original shareholders of Head Co will receive 0.4 new fully paid ordinary shares in Acquirer Co for each Head Co share held. The MV of each share in Acquirer Co is $12.50 and the MV of each share in Head Co is $5.

Post-completion, original shareholders of Head Co will own 40% of the merged group while acquiring shareholders will own 60%.



Consequences of roll-over:

The capital gains and losses from the following CGT events are disregarded.

- Reduction of share capital by Head Co of interests in Sub Co
- Disposal of interests in Head Co by Original Shareholders

For Original Shareholders:

- The cost base of the shares in Sub Co should be apportioned based on the relevant percentage (10% of original cost base in Head Co shares – noting that Sub Co represents 10% of the market value of the group as a whole). (Row 3 of Table 1)
- The sum of cost bases of shares in Acquirer Co and Sub Co should be the same as the original cost base in Head Co shares.
- The cost base of shares in Acquirer Co should be equal to adjusted cost base in Head Co shares prior to the merger, i.e. 90% of original cost base in Head Co shares.

For Acquirer Co:

- The cost base of the Head Co shares acquired will be calculated using the push up approach (Row 2 of Table 1).

EXAMPLE 3: RESTRUCTURE FOLLOWED BY PRE-ORDAINED EXIT

This example continues from Example 3 on page 24.

Figure A: Just before the restructure

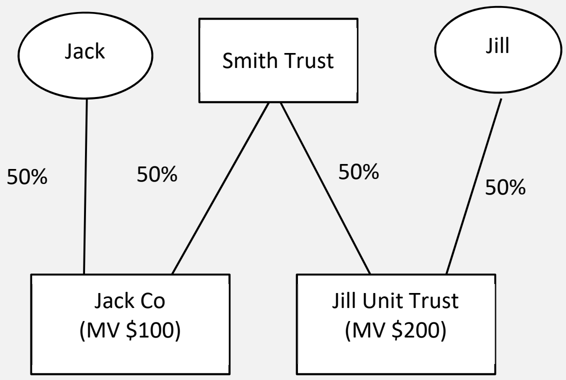
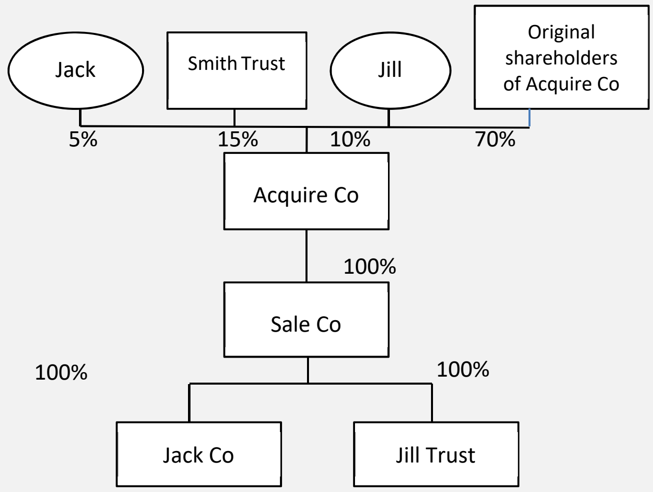


Figure B: Just after sale to Acquirer



The underlying ownership of Jack Co and Jill Unit Trust after the restructure is different to the underlying ownership before the restructure. This is a result of the scrip-for-scrip mergers involving Sale Co and Acquire Co. In order for general roll-over to apply to the whole of the restructure, the scrip-for-scrip transactions must satisfy specific merger rules. It does so – original owners were able to participate in the relevant transactions on substantially the same terms and the transactions results in Acquire Co acquiring more than 80% of Sale Co and Sale Co acquiring more than 80% of Jack Co and Jill Trust.

Consequences of roll-over:

The capital gains and losses from the following CGT events are disregarded.

- Disposal of interests in Jack Co to Sale Co
- Disposal of interests in Jill Unit Trust to Sale Co
- Disposal of interests in Sale Co to Acquire Co

Jack, Jill and Smith Trust's original assets before the restructure consisted of shares in Jack Co and/or Units in Jill Unit Trust. These were replaced by shares in Acquirer Co after the restructure (replacement assets). The cost base of replacement assets of Jack, Jill and Smith Trusts being shares in Acquirer Co will be determined by the rules in Row 3 of the Table.

The cost base of Sale Co's interests in Jack Co and Jill unit Trust are pushed up from Jack Co's and Jill Trust's assets (Row 2 of Table 1). Similarly, Acquirer's shares in Sale Co are pushed up from Sale Co's assets (Row 2 of Table 1).

QUESTIONS

13. Do you agree with the other proposed consequences for the general roll-over?
14. Are there any practical difficulties associated with these consequences? We would appreciate your submissions on potential solutions to these issues.

In your responses to the above questions, please include examples to illustrate your answer where possible.

Partial Roll-over

Partial roll-over is currently available under Subdivision 124-M when the consideration provided to acquire the target entity includes something other than ownership interests in the acquiring entity. The availability of partial roll-over for scrip for scrip takeovers and internal restructures can continue as a feature under the general model in recognition that, commercially, these transactions may include a cash component.

While most conditions of general roll-over can be applied by comparing the status of events just before and just after the restructure; when partial roll-over is provided under the general model a 'look through' approach may be required. For example, when multiple CGT events happen to a CGT asset under the restructure the taxpayer will need to look inside the restructure 'black box' to identify the appropriate taxing point where ineligible proceeds have been received.

The relevant CGT event identified would be excluded from the eligible restructure for the purposes of the general roll-over but may receive separate partial roll-over relief where the event satisfies the conditions of the general roll-over.

Under partial roll-over, the capital gains or losses will be worked out by first reasonably attributing a part of the cost base of the original asset to the ineligible part. The amount of the capital gains or loss is the difference between this cost base and the capital proceeds. There is no roll-over in respect of the ineligible part of the original asset for which it received ineligible proceeds.

PARTIAL ROLL-OVER EXAMPLE

As part of a restructure, Aim Ltd is demerged from its Head Company and subsequently acquired by LBL Ltd. Each Aim Ltd share is to receive 1 share in LBZ (market value $4) plus $1.

As the restructure involves the receipt of ineligible proceeds from the merger transaction, the transaction is excluded from the eligible restructure which continues to include a demerger and for which general roll-over may be applied. After the general roll-over rules determine the cost base of the Aim Ltd shares, partial roll-over is applied to the merger transaction.

After the demerger, Ken owns 100 shares in Aim Ltd. Those shares have a cost base of $2 (a consequence of the general roll-over). Ken has accepted the offer from LBZ Ltd to acquire those shares.

Ken chooses the roll-over to the extent that he can. The cost base of the ineligible part is ($100 x $200) / $500 = $40. Ken makes a capital gain of ($1 x 100 shares) - $40 = $60

QUESTIONS

15. Currently, partial roll-over is a feature of Subdivision 124-M and to a limited extent in Subdivisions 122-A and 122-B but not Divisions 125, 615 and Subdivision 126-B.

    a. Given that introducing partial roll-over to the general model will increase its complexity, to what extent (if any) should partial roll-over be available under the general model?

    b. Please provide examples of transactions which would not occur without partial roll-over?

4 DEMONSTRATION OF MODEL

A demonstration of the general roll-over concept has been developed as a means of generating thorough evaluation and informed feedback from the community on its feasibility. It summarises core elements of the general roll-over in a format familiar to end-users. It does not include ancillary rules discussed in other sections of this paper including:

- pre-CGT assets,
- partial roll-over,
- extension of relief for income tax consequences of shares held on revenue account, or
- the merger scrip-for-scrip rules.

However, it is anticipated that when read in conjunction with earlier discussions of the model, the Model Demonstration would assist Stakeholders in envisaging its application to a wide range of CGT transactions.

It is important to note that this model demonstration has not been endorsed by the Government. It has been written for the sole purpose of enhancing Stakeholders understanding of the preliminary model to facilitate consultation. For this reason, significant emphasis should not be placed on the exact wording used except to the extent that it reflects a particular policy setting discussed in other sections of this paper.

4.1 Eligible restructure and CGT event under an eligible restructure

1 A restructure is an ***eligible restructure*** if:

(a) the restructure is under a restructure scheme (whether explicit or objectively inferred from the circumstances); and

(b) the restructure starts at an identifiable time (the ***start time***) and ends at an identifiable time (the ***end time***) that is no later than 12 months after the start time; and

(c) a CGT event under the restructure happens at the start time; and

(d) under the restructure, one or more assets (the ***original assets***) that are held just before the start time are exchanged for one or more assets (the ***replacement assets*** in respect of the original assets) that are held at the end time; and

(e) the dominant purpose of the restructure is a commercial purpose; and

(f) in accordance with the restructure, each entity that held an original asset just before the start time holds one or more replacement assets in respect of that original asset at the end time; and

(g) the asset requirements in paragraph 2 are satisfied.

2 The asset requirements are satisfied if:

(a) each original asset, just before the start time:

(i) is a CGT asset; and

(ii) is an ownership interest or business asset; and

(b) each replacement asset, at the end time:

(i) is a CGT asset; and

(ii) unless subparagraph (iii) applies—is an ownership interest in a company or unit trust; and

(iii) if the eligible restructure involves the disposal of assets that are not ownership interests or if the ownership interests disposed of make up less than 80% of the ownership interests in the relevant entity—is an ownership interest in a company; and

(c) the market value of each original asset just before the start time is substantially the same as the market value or capital proceeds where partial roll-over of the replacement asset or replacement assets in respect of that original asset at the end time.

3 CGT events are "under" an eligible restructure only if each of those events happens at or after the start time and before or at the end time.

4 In determining whether a CGT event is "under" an eligible restructure take into account "commercial understanding" of the eligible restructure.

5 For the purposes of paragraph 1(d), an original asset may be (or be part of) a replacement asset (or part of a replacement asset).

Note: Under a demerger eligible restructure, a replacement asset may be an original asset.

4.2 Overview of requirements for roll-over

6 The roll-over is available for a CGT event if all the following requirements are satisfied:

(a) the CGT event happens under an eligible restructure, in respect of a CGT asset;

(b) every entity that is affected by the CGT event makes a choice for the roll-over to apply to the CGT event;

Note: It is proposed that this requirement will be taken to be satisfied if the transaction giving rise to the CGT event is an exchange of scrip for scrip.

(c) either:

(i) in comparing the start time and the end time, the ultimate economic ownership of either the original asset, or underlying assets representing the original asset (where the original asset is a membership interest), is maintained; or

(ii) if the asset is an ownership interest in an entity:

1. at the time of the CGT event the criteria for a merger scrip for scrip case are satisfied in respect of the entity; or

2. at the time of the CGT event, a change to ultimate economic ownership arises as a result of a capital raising and integrity requirements are satisfied and the entity is a public entity;

(d) the requirement in paragraph 8 is satisfied.

7 For the purposes of paragraph 6(c)(i):

(a) disregard ownership interests covered by employee share schemes and adjusting instrument rules analogous to those in existing section 125-75 of the *Income Tax Assessment Act 1997*; and

(b) disregard ownership interests that are shares held by entities if:

(i) those entities together hold no more than 5 shares in the relevant entity; and

(ii) the market value of those shares expressed as a percentage of the market value of all the shares in the relevant entity is such that it is reasonable to treat the remaining shareholders as owning all the shares in the relevant entity.

8 The requirement in this paragraph is satisfied unless any of the following apply:

(a) another roll-over applies in respect of the CGT event;

(b) if the replacement asset(s) is/are not taxable Australian property just after the end time—the [final recipient] is a foreign resident, or a trustee of a trust that is a foreign trust for CGT purposes;

(c) the final recipient is a tax exempt entity;

(d) any capital gain from disposing replacement interests would be disregarded (except because of a roll-over);

(e) the CGT event results from a transfer between a member of a consolidatable group, except if the restructure results in:

(i) the transfer of a CGT asset from a trust or partnership to a company; or

(ii) the interposition (100%) of a holding company.

4.3 Consequences of roll-over

9 If the roll-over is available for a CGT event, disregard a capital gain or capital loss from the event.

10 If the roll-over is available for one or more CGT events:

(a) work out the cost base of a replacement asset in respect of one or more original assets by reasonably attributing to it the cost base of the original asset just before the start time; and

(b) work out the cost base of an original asset by:

(i) in the case of an ownership interest—applying a method analogous to that in section 124-784B of the *Income Tax Assessment Act 1997*; or

Note: It is proposed that an alternative method may be available in some circumstances.

(ii) in the case of a business asset—attributing to it its cost base just before the start time.

QUESTIONS

16. Paragraphs 1(d) and 5 of the Model Demonstration provides a definition for original and replacement assets. Are there any difficulties with classifying assets into these two categories? Please include examples to illustrate your answer where possible.

17. It is important that the benefits of the preliminary roll-over model are also well understood. Compared to the current suite of roll-overs, what are the key simplifying features that would provide the most value in a general restructure roll-over? What other features of the preliminary roll-over model provide important benefits?

5 KEY POLICY ISSUES

The general business roll-over aims to synthesise a range of discrete roll-overs with disparate features. These differences are sometimes technical in nature (such as inconsistent use of language to convey similar concepts) and, in other cases, may involve significant policy differences.

This part of the paper first provides a summary of how the proposed model seeks to resolve the disparities in the existing roll-overs. It then highlights more significant policy issues, some of which we have incorporated into the model to demonstrate the benefits of the approach but that, nonetheless, need further exploration. The aim of this section is to invite your views on whether, having regard the principled framework, there is a case for either extending or limiting relief in order to achieve greater equity, simplicity and policy coherency.

5.1 Broad policy issues

Relief for demergers done in conjunction with capital raisings

The general roll-over relief model is designed to incorporate the demerger relief currently available under Division 125. As with almost all roll-overs designed to overcome asset lock-in, demerger relief is predicated on the core condition that underlying economic ownership is maintained. This principle clearly influences the way in which the ATO administers demerger relief, supported by the historical policy justification articulated in the *Review of Business Taxation* – that a demerger *leaves* the ultimate owners in the same economic position as they were before the restructure.

Initial consultations highlighted that the law is unnecessarily constraining in the way it puts roll-over relief at risk when capital market transactions are known, planned or intended to occur in concert with the demerger resulting in significant uncertainty. Such transactions that appear to change the economic position of the ultimate owners after a demerger is inherently problematic. However, stakeholders regard the law[19] as applied as encroaching too far into commercial decision making.

The argument being advanced here is that, absent a preceding demerger, a company's Board is largely free to raise equity finance without triggering CGT. As a principle, CGT does not make share issues taxable, even though they trigger an economic transaction for the existing shareholders. However, where the capital raising follows a demerger, there is a significant risk that demerger relief will not be available. Some stakeholders assert that there is no good policy reason why this should be the case and that the appropriate benchmark for a post-demerger capital raising ought to be the tax outcome that would result from the head entity of a group undertaking a similar equity-raising transaction.

Secondly, stakeholders have noted that one of the main commercial benefits sought by demerger relief is to improve access to equity finance to enable that subsidiary to realise its potential. A conglomerate may be undertaking two diversified businesses, with the capital markets attracted to one of the businesses and not the other. For example, consultations highlighted that groups with innovative e-commerce business lines have a very different cost of equity capital and often need to achieve a structural separation to better realise growth potential.

[19] As interpreted by the ATO in Tax Determination 2020/6.

Thirdly, in practice, decisions relating to the capital structure of a future demerged subsidiary are often made at or about the same time as the demerger. Often, it is the case that an entirely separate management structure, including an independent board of directors, is established before the discrete demerger transaction. That separate decision-making body will be assessing the standalone balance sheet of the entity housing the separate assets and making decisions regarding its capital needs.

The Board would like to explore ways of aligning the general roll-over with commercial practice by reducing the constraints on post-demerger transactions, particularly equity raising. The general model provides a valuable opportunity to address the ambiguity.

QUESTIONS

18. What constraints should be put in place on the availability of roll-over where a capital raising has occurred? Should any subset of transactions be excluded from these constraints, for example, public companies that are subject to strict regulatory control?

19. In what circumstances do capital raisings give rise to integrity concerns such as inappropriate value shifting? How could these concerns be addressed?

20. Should the cost base of replacement interests be adjusted to reflect any dilutionary effect of a capital raising?

21. Are there scenarios apart from demergers where it would be appropriate for roll-over to be available for a reorganisation that includes a capital raising component?

22. Are any ongoing impacts of COVID-19 expected to change the nature of future capital market and demerger transactions?

Treatment of pre-CGT assets

It is generally the case that, where the realisation of a CGT asset qualifies for roll-over, the pre-CGT exemption is preserved. The general rule is applicable to both replacement asset roll-overs and same asset roll-overs.

A significant exception to the general rule is the scrip for scrip roll-over in section 124-M. Pre-CGT shares, units or other interests are ineligible for scrip-for-scrip roll-over. The replacement scrip is therefore taken to be post-CGT asset with a cost base equal to its market value just after the acquisition.

The Board considers that, in a mature CGT system, the persistence of a pre-CGT exemption is inconsistent with its principled framework. It is inequitable, because it excuses some entities based purely on when an asset was acquired, and inefficient, because it increases ‘lock in’ and encourages tax planning activities designed to perpetuate the exemption. And most importantly for the proposed roll-over, the pre-CGT exemption increases legislative complexity. This would be particularly pronounced for the general roll-over because it applies both to takeovers and internal reorganisations.

In light of the above, the Board believes there would be merit in a including in the general roll-over a rule specifying that any assets received in exchange for pre-CGT assets will be taken to be post-CGT assets with a cost base equal to their market value at the time of the restructure.

Although it would represent a significant change for the minority of restructures involving pre-CGT assets, it would deliver significant net benefits to the system as a whole and better align the CGT system with the principled framework.

QUESTIONS

23. Would you support a general rule that assets received by way of replacement for pre-CGT assets will be taken to be post-CGT assets with a market cost base? Why? Why not?

24. Can you suggest ways for dealing with pre-CGT assets under the general roll-over that that would provide maximum simplicity?

Treatment of Attribution Managed Investment Trusts (AMITs)

An attribution managed investment trust or AMIT is a type of collective investment trust that has chosen to be taxed under the attribution rules in Division 276.

A concern among some stakeholders is that AMITs have limited access, if any, to the existing business restructure roll-overs. This is because some key roll-overs are subject to a condition that can only be satisfied if CGT event E4, a provision dealing with non-assessable distributions by trusts, is capable of applying to all of the units and interests in the trust. This is to prevent discretionary trusts from accessing the roll-overs. However, CGT event E4 is subject to a specific exception that prevents it from applying to AMITs. Instead, AMIT are subject to a different event, CGT event E10.

Having regard to our policy framework, the Board believes there are a number of reasons why, in principle, general roll-over may be extended to AMITs. Most relevantly:

- the E4 mechanism is a proxy for ensuring that a trust is sufficiently fixed or non-discretionary which in turn provides confidence that a restructure demonstrates the sufficient degree of continuity of ownership. An AMIT is, by definition, no more discretionary than a trust that satisfies E4.

- there is no concern that a restructure involving an AMIT would involve the transfer of assets to a more tax advantaged entity.

In light of these factors, the Board believes consideration should be given to extending existing policy to enable AMITs access to the general roll-over. This could be achieved by including a reference to CGT event E10 in the CGT roll-over provisions.

A possible concern with extending general roll-over to AMITs is that it may subvert the requirement for an irrevocable election to enter the regime. That is, it would enable the entity that has made an irrevocable election, to take some part of its business outside the AMIT regime.

QUESTIONS

25. Would extending general roll-over to trusts that satisfy CGT event E4 or E10 make relief practically available to AMITs? What additional obstacles, if any, would prevent relief being accessed?

26. For what types of arrangements would AMITs contemplate using general roll-over?

27. Would giving AMITs access to general roll-over be inconsistent with the requirement for an irrevocable decision to enter the AMIT regime? How could this concern be addressed?

Reconciling Division 615 income tax relief with the general model

The relief available under the suite of existing roll-overs is generally limited to the deferral of CGT. The main exception is the relief provided for business restructures under the Division 615 roll-over (for the interposition of a holding company), which defers the income tax consequences for the exchange of membership interests held as trading stock or on revenue account.

In absorbing Division 615 into the general business restructure roll-over, consideration must be given to preserving this setting and applying it to all transactions eligible for relief under the model, or otherwise discarding it. Initial consultations urged consideration be given to extending Division 615 relief more broadly to other restructure roll-overs.

Given the precedent established with the broad-based income tax relief of Division 615 (and similarly, the income tax deferral provided in the recently enacted small business restructure roll-over) the Board is considering recommending applying the same policy setting to all relevant transactions eligible for relief under the general model. Such treatment would provide the maximum flexibility for businesses to transition to a more appropriate structure in a post COVID-19 environment and is consistent with the goal of simplifying the process of giving advice on roll-overs and reducing the regulatory burden on affected businesses.

One important limitation that will have to be maintained in the general model is the rule restricting relief to circumstances where the replacement asset under a restructure is of the same character as the replaced asset (the same character rule). In the absence of this rule, a gain deferred at the time of the restructure would not be recaptured at a later point. Such an outcome is contrary to our guiding principle that roll-over defer, and not exempt, gains.

QUESTIONS

28. What implementation issues should be taken into account in extending relief in this way?

29. Are there any integrity issues that the Board should have regard to in extending this treatment to merger and takeover transactions?

Removal of like-for-like requirement in the General Roll-over

The existing scrip-for-scrip roll-over is currently only available when like interests are exchanged, i.e. there must either be a share for share exchange or unit for unit exchange. However, initial consultations suggested that there is no continuing policy reason why that strict requirement should be maintained in a general roll-over model.

The Board would support removing the 'like-for-like' requirement and allowing the general roll-over to apply where units are being swapped for shares (or vice-versa) provided it would *not* lead to assets being transferred into a more tax-advantaged entity or result in more favourable tax outcomes.

The Board's preliminary thinking is that removing the like-for-like requirement would not create tax arbitrage opportunities. First, unit holders are generally entitled to the income and/or capital gain of the trust that is proportionate to their unit holding, similar to shareholders of a company. It is not possible for the unit trust to 'stream' different amounts of income and capital gain to different unit holders having regard to their ability to access the CGT discount.

Secondly, whilst a unit trust is generally a flow-through vehicle, unitholders in receipt of discounted capital gains can only retain the discount if they are ordinarily eligible to access the discount. In practice, if a unit trust distributes discounted capital gains to its unit holders, the unit holders are required to first "gross up" the capital gain and offset it by any capital loss the relevant unit holder has before the remaining capital gain is subject to the 50% CGT discount (if eligible).

QUESTIONS

30. What integrity issues or practical difficulties should the Board give further consideration to in removing the like-for-like requirement?

Interaction with the consolidation regime

As noted in Part Two, the proposed general roll-over incorporates a principle that a transaction will not qualify for relief if, had it been undertaken within a tax consolidated group, it would have been disregarded because of the single entity rule. This means that, as is currently the case, relief would not generally be available for transfers of assets between member entities of a consolidatable group. This complicates the model as allowances are necessary to ensure relief continues to be available where assets are transferred from a trust or partnership to a company and where the transaction effects the interposition of a holding company.

In consultations, some stakeholders suggested that it may be timely to revisit the policy concerning the application of restructure to consolidatable, but non-consolidated, groups. While, when it was first enacted, there was value in having strong incentives to encourage businesses to enter the regime, there are very valid reasons why some businesses choose not to consolidate. For example, many smaller businesses choose not to consolidate because the cost setting process is a significant barrier to entry, outweighing any simplification benefits they might later enjoy. It was asserted that businesses that choose not to consolidate would benefit significantly from regaining the ability to move assets freely around a wholly-owned group without triggering a tax liability.

On the other hand, the Board notes that introduction of the consolidation regime was partly a response to integrity issues arising under the pre-existing 'grouping' concessions (including subdivision 126-B as it then operated). It would be important to ensure that any departure from current policy would not revive those integrity issues.

QUESTIONS

31. Should the policy surrounding the application of business restructure roll-over relief to arrangements involving consolidatable groups be revisited? On what grounds?

32. Would allowing relief for asset transfers between members of a wholly-owned group give rise to integrity issues and, if so, how could they be addressed?

The general business roll-over and the small business sector

The Board has considered how the general business roll-over would apply to the small business sector.

It is noted that, in terms of businesses restructuring, the landscape for small businesses is quite different than for their larger counterparts. In short, small businesses tend to have a more tools at their disposal for reducing or eliminating any CGT or other tax liabilities that would otherwise arise from a business restructure.

A typical small business restructure could involve any of the following:

- use of the general CGT discount in combination with one or more of the small business concessions in Division 152 of the ITAA 1997–this may or may not include the dedicated small business roll-over in subdivision 152-E;
- the small business *restructure* roll-over in subdivision 328-G;
- the general replacement asset roll-overs in Divisions 122 and 124.

A small business restructure may also employ a combination of these concessions, either sequentially (as part of a back to back roll-over arrangement) or concurrently. However, combining roll-overs in respect of a single arrangement may create additional uncertainty as to whether tax relief is available, either because it would cause the failure of a technical roll-over requirement or because it would enliven the general anti-avoidance rule.

The Board considers that there is scope for significantly improving the co-ordination between the various CGT concessions available to small businesses. The current rules, while arguably creating flexibility for small business owners, also greatly increase the complexity and compliance cost involved in design and executing a restructure. A more coherent model could involve:

- confining the operation of Division 152 to arm's length disposals and replacements of assets;
- establishing the SBRR as an exclusive code for business restructures by small business entities; and
- making the proposed general roll-over available to only those entities that are ineligible for SBRR (that is, entities with aggregated turnover of $10 million and over).

In advance of more significant reforms to Division 152 and the SBRR, the Board is proposing that the general business roll-over relief would be available to all businesses, including small businesses that are eligible for relief under Division 152 or the SBRR. However, a small business that opts to use the general business roll-over would not be able to combine it with other concessions.

QUESTIONS

33. Would there to be demand from the small business sector to use the general business roll-over given the availability of alternative methods of reducing or eliminating tax liabilities?

34. Would you support reforms to establish more clearly defined functions for Division 152 and the SBRR?