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Board of Taxation
CGT roll-over review - Consultation Paper
12 February 2021

Board of Taxation Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: cgtroll-overs@taxboard.gov.au

Dear Members,

Review of CGT Roll-overs – Consultation Paper (December 2020)

Thank you for the opportunity to comment on the Board's paper, *Review of CGT Roll-overs – Consultation Paper* (December 2020) (**Consultation Paper**).

The focus of our submission is on the issues affecting listed public and large private groups, and is informed by both our extensive experience in public markets and large private transactions, and by discussions on the Consultation Paper with a number of participants in M&A markets, including leading investment banks and corporate lawyers in our affiliated firm, Herbert Smith Freehills.

We have focussed our submission on the policy framework and outcomes, rather than the exact wording of the Board's Model; work on drafting detail can be done subsequently. We welcome the general thrust of the Board's plan for improving this difficult area of tax law, and we endorse many key features of the Model, including:

- allowing taxpayers the choice to disregard the tax consequences of some events when determining what constitutes the "restructure";
- allowing a post-demerger capital raising;
- allowing post-demerger take-overs;
- allowing back-to-back transactions to qualify for roll-over; and
- abandoning the 'like-for-like' requirement for scrip for scrip transactions.

These are welcomed proposals and would bring about substantial improvement to the current law and practice.

We have only a few specific reservations about the Model; we explain them in more detail in the Appendix. In short they are:

- the proposal to reconstruct the cost base in scrip-for-scrip transactions - this is a fatal flaw;
- the commercial purpose test, which we consider can be dispensed with for listed entities (if not all together); and
- limiting rollover to 'business' assets rather than income-producing assets more generally.

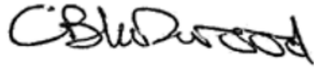
We also note the omission of any changes to s.45B and allowing demerged groups to retain the tax cost of their assets rather than resetting them via the tax consolidation rules.

But we are concerned that enacting the Board's Model will prove too hard and slow because the plan is so ambitious. Consequently, we would encourage the Board to consider a 'Plan B': a few tweaks to the current rules (as an interim step, if not a final destination) to remedy some existing problems in Subdivision 124-M and Division 125; we identify key measures in section 5 in the Appendix. This will facilitate an immediate

improvement to the key roll-overs that drive business restructuring so that business assets are put to their highest and best use in economic terms, and will allow the goal of a post-COVID business led recovery to be met.

We would be happy to discuss with the Board our submission in more detail, and are happy to facilitate discussions with non-tax participants in the M&A market.

Yours sincerely



Cameron Blackwood
Partner
Greenwoods & Herbert Smith Freehills

+61 2 9225 5950
+61 421 046 803
cameron.blackwood@greenwoods.com.au

Richard Hendriks
Partner
Greenwoods & Herbert Smith Freehills

+61 2 9225 5971
+61 403 103 828
richard.hendriks@greenwoods.com.au

Appendix – Submission on the Consultation Paper

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1 Summary

Fixing the demerger and scrip-for-scrip roll-over provisions are vital to a post-Covid-19 business-led recovery

(a) The Board has rightly added the economic recovery from the shock delivered by COVID-19 to the framework in which to consider the reform of CGT roll-overs, consistent with the direction of the October 2020 Budget.

In our view, the fastest and largest economic impact in this area will be achieved by a focus on the two main roll-overs that drive business restructuring so that business assets are put to their highest and best use in economic terms – being the Subdivision 124-M scrip-for-scrip roll-over and the Division 125 demerger roll-over. This will allow business to restructure (whether by amalgamating or dividing their operations or a combination of the two) without tax as an impediment and will help deliver on this goal.

(b) The key policy recommendation that should be implemented as soon as possible is the introduction of specific “exceptions” to the demerger requirement of the maintenance of underlying economic ownership rule for qualifying scrip-for-scrip roll-over transactions and capital raisings. Together with the introduction of a rule to permit the exclusion of transactions from the tested “restructure”, this will go a long way in ensuring that the CGT roll-over provisions no longer inhibit genuine business restructures.

The Consultation Paper framework has many positive elements that should be adopted

(c) We generally support the concepts depicted in the “flow-chart” in the Consultation Paper on p. 28 as the way of framing a generic set of rules. That is, as a general concept, CGT roll-over should be available for qualifying business restructures where:

- there is no change in underlying economic ownership; or

- there is a change in underlying economic ownership that is due to a qualifying scrip-for-scrip transaction or capital raising.

(d) In particular, we agree with the following policy proposals outlined in the Consultation Papers and would urge that they be adopted quickly:

(1) The concept of "eligible restructure" should be such that "back to back" roll-overs are achievable.

(2) The introduction of a rule into the demerger provisions to permit the exclusion of particular transactions from the tested "restructure".[1]

(3) Roll-over relief should still be available (particularly for demerger transactions) where the change in economic ownership is due to a connected capital raising or a scrip-for-scrip merger transaction.

(4) Abandoning the "like-for-like" requirement (i.e., allowing a company to acquire a trust; allowing a trust to acquire a company).

The proposed cost base amendments to the scrip-for-scrip rules should not proceed

(e) The current regime that allows a market value cost base for an acquirer under a scrip-for-scrip regime should be maintained (with the current integrity measures for top-hatting, significant stakeholders etc.). The change proposed by the Consultation Paper would make scrip-for-scrip transactions for public transactions largely untenable and significantly dampen genuine business restructuring and the flow-on positive economic benefits. This is because the go-forward tax basis of assets is a key factor for a purchaser, for whom the use of their Scrip is, in effect, the payment of market value consideration.

The proposed 'commercial purpose' test should not be pursued in its current form

(f) The proposed 'commercial purpose' test is likely to prove a new source of conflict and uncertainty, with the ATO second-guessing the motives and outcomes of commercial transactions. If the commercial purchase test is not to be discarded, then it should at least be switched off for transactions by listed groups; their transactions will have required the scrutiny by a court (for a scheme of arrangement) and ASX/ASIC.

The 12-month rule requires further thought

(g) Many sizeable restructures will take longer than 12 months to achieve, if the asset assembly phase forms part of the restructure. It may not be possible to defer the start of the restructure (and the deferral of gains) to a point where the 12-month rule can be met.

In any event, we consider that the proposal to allow transactions to be excluded from the relevant restructure will go a long way in addressing the current interpretational issues with the scope of the "restructure".

An alternative approach – targeted amendments instead of a general business restructure roll-over

(h) Given our view that the demerger and scrip-for-scrip changes are by far the most important, we are concerned that attempting to legislate a roll-over which encompasses these important M&A roll-overs within a wider change of business restructure roll-overs may unnecessarily delay these improvements.

(i) We suggest that another approach (perhaps as an interim measure) would be to "fix" the existing roll-over provisions with a series of targeted changes to the demerger provisions in Division 125 and the scrip-for-scrip roll-over provisions, consistent with the policy positions taken in the Consultation Paper.

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[1] See pp.20-21 of the Consultation Paper.

We have outlined below in section 5 a series of targeted amendments to the scrip-for-scrip and demerger provisions which we feel would address most of the current problems.

Roll-overs for trusts

(j) We consider that trusts within the AMIT regime should be able to access any genuine business restructure roll-over (**GBRR**) that is developed and that in the short term amendments to ensure AMITs can access the demerger roll-over and the 100% owned group roll-over are made, in the latter case with integrity rules if necessary in relation to AMIT trust losses.

(k) Further, we consider that trusts which satisfy CGT event E4 and can currently access the demerger roll-over should also be able to access the wholly-owned group roll-overs in Subdivision 126-B.

2 Our comments on the Consultation Paper

Demergers and scrip-for-scrip transactions undertaken by listed public and large private groups are invariably complex, protracted and expensive projects undertaken to achieve certain commercial objectives. The usual commercial reasons are:

- in the case of a demerger: the underlying net assets are seen as having greater value housed in separate entities with separate ownership even if the same parties initially own the same proportionate interest and value in both entities; and
- in the case of a scrip-for-scrip transaction: the amalgamation of the entity (sometimes, a demerged entity or a demerging entity) or entities with another entity or entities will allow business synergies and potential value to be realised.

In either case, after separation and / or amalgamation of the businesses, prudent financial management will often require additional equity in the demerged entity / amalgamated entities to enable them to establish their separate viability in the marketplace. Hence it is often an explicit or implicit part of a restructure by demerger that the demerged entity or entities will raise additional equity capital and the demerger will more likely be successful if this is prearranged.

The ATO's interpretation of the demerger and scrip-for-scrip rules, seen in some Class Rulings and TD 2020/6, can deny demerger roll-over when a capital raising is envisaged or when a pre-planned amalgamation will occur.

Such outcomes achieve no policy goal (assuming the integrity requirements are satisfied) and we support any measure which will, as the Board puts it, '[align] the general roll-over with commercial practice by reducing the constraints on post-demerger transactions, particularly equity raising' [p. 45].

It is sometimes argued that demergers combined with other transactions are, in effect, just asset sales, and that the only reason a demerger combined with another transaction is used is to obtain the tax-free treatment. This argument overlooks the fact that the sale of a business is a mix of assets and liabilities and that while assets may be transferrable to another party without difficulty, liabilities cannot generally be transferred without the consent of a third party. Even for complex assets, direct transfers are often legally difficult. Hence, from a commercial perspective, by far the easiest – and often the only – way to transfer a large business is to transfer the legal entity or entities in which the business is housed as this automatically packages the assets and liabilities together and does not generally disturb the relationships between the entities concerned and third parties.

Further, the commercial preference is often for the 'unwanted' assets (i.e., the real estate assets from the example in the Consultation Paper) to be retained by the current

shareholders – as a result of the ATO's current views, this has resulted in many transactions simply not occurring due to the tax impediment caused by the demerger provisions not operating as intended.

So we welcome the general thrust of the Board's plan for improving this difficult area of tax law, and we endorse key features of the Model:

- allowing taxpayers the choice to disregard the CGT consequences of some [consol] events and not others [p. 21]
- allowing taxpayers a choice about when to start the 12-month restructure window [p. 22]
- allowing a post-demerger capital raising [p. 44-45]
- allowing post-demerger sales [p. 24]
- allowing back-to-back transactions to qualify for roll-over [p. 31]
- abandoning the 'like-for-like' requirement [p. 47].

3 Some problems with the Model

While we strongly support the Board's efforts and many of the positions taken in the Consultation Paper, we note below a few problematic aspects of the Consultation Paper.

3.1 Scrip-for-scrip cost base change should not be implemented [Questions 9-12]

By far the most problematic aspect of the Model is the proposal to:

> *… [employ] 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* [p. 32]

It has been suggested to us – and we agree this is the likely outcome – that there will be no scrip-for-scrip roll-over transactions by large and listed entities if this proposal is enacted. It will kill the market; scrip-for-scrip rollover transactions for public entities would become largely untenable.

The reason is that a bidder will not be able to quantify the potential (adverse) impact of the cost base rule prior to completion of the transaction and will not be able to ascertain it with any certainty until well after the deal has been concluded – in essence the bidder is 'flying blind' until it can get its hands on the target's records, and then has sufficient time to verify them. The only ways the bidder can get certainty is to pay cash – which will be less appealing to sellers, and will likely either drive up the price of M&A transactions, or choose to deny rollover (s.124-795(4)) which defeats the idea of a roll-over in the first place. The cost base push-up rule no doubt attempts to deliver simplification, but it results in anomalous outcomes for scrip-for-scrip transactions. This is illustrated in Diagram 1.

We acknowledge that the current regime, which allows a market value cost base for an acquirer under a scrip-for-scrip transaction, is a departure from a cost base transfer system. The Consultation Paper suggests that the current approach was adopted because, '[a] cost base transfer … can give rise to compliance costs … where the target company is widely held' [p. 32]. We think the following case is rather stronger: a cost base transfer system could just never be accomplished where the target is widely held – record-keeping by humans is simply too flawed.

In our submission, allowing a market value cost base (with the current integrity measures for top-hatting, etc.) to remain is the only achievable rule when compared to the alternatives:

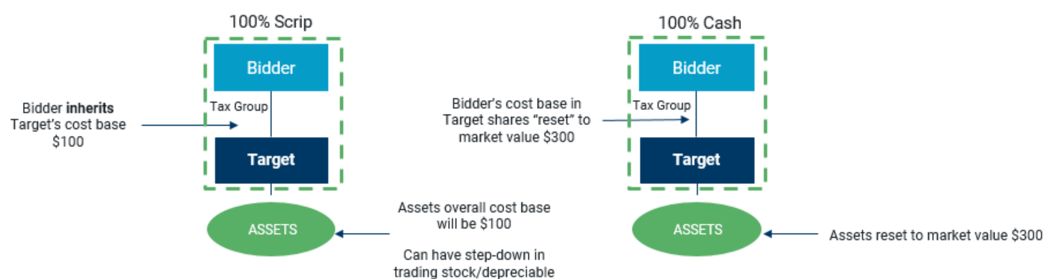
- a cost base transfer from the current shareholders; or
- a cost base derived from the cost of the target's assets.

The Consultation Paper rightly makes the point that roll-overs exist to remove unnecessary impediments to efficiency enhancing commercial transactions; the cost base push-up proposal will fundamentally contradict that aspiration.

+ Diagram 1 – current cost base rules should be maintained

Proposal

- Remove market value cost base if scrip used.
- Replace with "push-up" approach (look at underlying cost base of assets/liabilities of target).
- Negative impact if target joins bidder's tax consolidated group.
- Assume for both cash and scrip bid that purchase price of Target shares $300 and cost base of Target's assets cost base $100.



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3.2 Commercial purpose test [Question 6]

Our concern here is that the application of the vague commercial purpose test will create complexity, uncertainty, delay and significant compliance costs through engagement with the ATO, which together will likely make the GBRR less attractive than the current rules and lead to slow take-up. In short the test will dampen restructure activity not enhance it. The Consultation Paper does not allude to the experience of the tax community with the relatively recent small business restructure roll-over (**SBRR**). This measure was deliberately designed to be a principle-based regime using the central concept of a "genuine restructure", making it similar in several respects to the proposal in the Consultation Paper.

Elsewhere, the Board has identified many concerns with the SBRR, most importantly for present purposes that the "genuine restructure" requirement is "clearly the most contentious aspect of the SBRR [and] is seen by stakeholders as increasing complexity and compliance costs, and creating uncertainty." Further, "[c]riticism was also directed at the ATO's interpretation of the genuine restructure requirement."[2] As a result the Board recommended a post-implementation review in the relatively short term and clearly favoured considerable expansion of the roll-over and away from the problems created by the genuine restructure requirement. Such a review will be relevant to the use of the

[2] The small business roll-over is in ITAA 1997 Div 328-G. For the problems identified, see Board of Taxation, Review of Small Business Tax Concessions (2019) pages 79-91.

genuine restructure requirement in the GBRR and is likely to further slow the development of a wholly new roll-over.

The Board's review of the SBRR occurred in the pre-COVID-19 environment. In the post-COVID-19 environment where the emphasis is on restarting the economy (which the Board has noted in the Consultation Paper), our view is that the commercial purpose test should not form part of the immediate response but be considered along with the SBRR and as part of any longer term project to develop a workable and efficiency-enhancing GBRR. If the Board considers that the test should be pursued as part of the initial package, consistent with the direction of the Board's initial thinking on the SBRR, it should be switched off for transactions that fall within defined safe harbour categories. In this case we consider that any safe harbour should include restructures by listed groups as their transactions will have required scrutiny by court (for a scheme of arrangement) and the ASX/ASIC, and, in any event, commerciality will be subject to scrutiny in the public markets and the financial press.

See further section 4 for some broader concerns with the current direction of the GBRR.

3.3 Offering roll-over for 'business' assets (and not investment assets)

The roll-overs chosen for the GBRR are a mix of cases where assets which are not ownership interests may be transferred and where the assets transferred can only be ownership interests. In the former case to the extent the assets are not ownership interests, it is necessary that they be business assets. This seems to mean that for some existing roll-overs such as Div 122-A, the new roll-over will be narrower and so it will be necessary to retain the existing roll-over for investment assets. This would similarly affect Div 126-B roll-overs as the asset transferred under that roll-over could be ownership interests or not and in the latter case it would be necessary that the asset be a business asset which is narrower than the current law. Further the test suggests that in the case of transfers of ownership interests there need not be an underlying business or business assets and an investment activity would be enough unless the commercial purpose test is meant to imply that there is a business.

In our view, this kind of partial replacement of existing roll-overs will end up complicating the law rather than simplifying it and will bring with it the same kind of borderline problems as the commercial purpose test – if the asset is not an ownership interest is it a business asset or an investment asset, assuming that business here is meant to have its usual tax meaning. Further it will lead to even more complexity in other areas of the legislation which effectively borrow the roll-overs proposed to be covered by the GBRR for assets which can be business or investment assets, most notably depreciating assets covered by s. 40-340(1) items 1, 2, 2A, 3, 5.

We suggest that this test be dropped or that the 'business asset' component be extended to investment assets (assets being held to produce income and/or capital gain). This will also avoid issues of 'business v. investment' both for companies, and more especially for trusts, if trusts are included in the GBRR – the conclusion that an asset is not a business asset is very likely to arise in the case of a trust (see also section 6.5 below).

3.4 Limiting the deferral only to capital gains [Questions 28-29]

The Consultation Paper [p. 47] asks whether the extension of the Div 615 roll-over to assets beyond those on capital account should be replicated in the GBRR. The implication seems to be that this is the only roll-over that extends more generally but as noted above, s. 40-340 achieves the same result in relation to depreciable assets for a number of other roll-overs and it is not the only provision giving some roll-overs a more extended operation (e.g., Div 615, Div 328-G).

In our submission, if a GBRR is developed then it would be desirable for it to extend to other kinds of assets apart from those held on capital account. This, however, would again complicate the drafting exercise, require more extensive amendments of the legislation, and necessitate more rigorous testing before being implemented.

For the reasons we discuss in section 4, we consider that timely reform is more likely if changes are made to specific roll-overs. Consequently, the Board may wish to consider whether this change should only be made to the existing CGT roll-overs to get the benefits from change on a more timely basis.

3.5 Section 45B

Currently, the Consultation Paper makes no reference to s.45B ITAA 1936. A thorough discussion of a workable regime for demergers should take into account the workings of s. 45B, and some of the problems with its administration.

The current administration of s. 45B represents a real impediment to demerger activity because of the ATO's reliance on the concept of 'genuine demerger.' This term has been used to deny demerger relief in cases where there is a post-demerger sale of the demerged company – the transaction discussed at p. 24 of the Paper, and which the Board's proposals would allow: '*a pre-ordained sale of replacement interests that follows a roll-over could form part of the restructure*' [p. 20]

The phrase 'genuine demerger' occurs in the Explanatory Memorandum to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002*. It does not appear on the face of legislation, and so it is gloss on the statute.

We note this history because there must be some concern that a GBRR would be similarly curtailed unless the Board recommends adjustments to s. 45B as part of the GBRR package of amendments.

4 Our concerns with an ambitious GBRR

At first glance, the idea of consolidating several CGT roll-overs seems a sensible way to eliminate a degree of complexity from the tax legislation and the Board is to be commended for taking seriously the Minister's instruction to, "to identify and evaluate opportunities 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." But we are concerned that the positive changes outlined in the Consultation Paper may be unnecessarily delayed whilst complex comprehensive legislation is developed.

Our concerns are not imaginary. First, this is not the first time the Board has looked at the problem of the great variety of different rules in roll-overs and their overlapping and underlapping coverage.[3] In previous cases, the Board has decided not to pursue the matter further for the time being or the Government has not adopted and implemented the Board's recommendations.

Secondly, the scope of the GBRR is targeted at both roll-overs which are key to additional economic activity generated by M&A transactions where there is a change in economic ownership (such as Div 124-M) and roll-overs directed at a mere change in business structure. In our view, there are really several different concerns in the regimes listed in the Consultation Paper for consolidation into the GBRR:

- roll-overs for top-hatting [Divs 122-A, 122-B, 124-N, 615] – merely replacing the current top of the business structure with a different legal entity (the first three of these reflect the 'incorporation bias' which the Board identified in the

[3] See in relation to the Board's consolidation post-implementation review, Board of Taxation, Post-implementation Review of Certain Aspects of the Consolidation Tax Cost Setting Process Discussion Paper (2012) ch 7, Board of Taxation, Post-implementation Review of Certain Aspects of the Consolidation Tax Cost Setting Process: A Report to the Assistant Treasurer (2013) ch 7; and in relation to the asset merger roll-over relief review, Board of Taxation, Report Introducing an Asset Merger Roll Over Relief: A Report to the Treasurer (2017).

Consultation Paper); the same policy underlies Div 124-E, 124-F, 124-Q and other roll-overs not addressed in the Consultation Paper;

- roll-overs for movement of assets between existing companies within the same 100% corporate group [Div 126-B]; unlike in other areas where movement between different kinds of legal entities is possible (such as the SBRR), this roll-over also reflects the incorporation bias in existing roll-overs;
- roll-overs for business divisions [Div 125] – this represents a split or division of an existing stake, which typically occurs tax free; the same policy underlies provisions in other parts of the Act such as s. 40-115 and s. 112-25;
- roll-overs for business amalgamations [Div 124-M] – this represent a departure from the same owners same underlying asset policy under the previous cases in that it reflects amalgamation of assets and their ownerships which has elements of disposal and acquisition of assets on each side of the ownership but under general CGT concepts only the disposal on one side is recognised for tax purposes which creates a tax distortion to economic returns depending which side of the transaction the particular owner is on;
- combined business divisions and amalgamations (Div 125 combined with a capital raising or a takeover which may or may not be eligible for Div 124-M relief); this combination involves both the policies under the two previous points and so goes beyond the same asset in same ownership underlying the first three points.

Since the identified roll-overs exist for different tax policy reasons, it may be difficult to have one common set of rules that can accommodate those policies. Combining different types of roll-overs into a single GBRR may mean repeating the complexity of the existing roll-overs in order to satisfy the requirement in the terms of reference that any new rules will have, 'a substantially similar practical effect.'

Thirdly, the Consultation Paper does not reference the Board's review of the SBRR which we have outlined above in section 3.2.

Fourthly, as with any significant change to important areas of the legislation, new issues of interpretation will arise and there are likely to be unintended consequences, which recent experience with the legislative process suggests is very difficult to unravel or correct. For example, the GBRR proposal seems to exclude private transactions from existing current "top-hatting" roll-overs, which is likely a policy "casualty" and not an intended outcome.

For us, this background argues against trying to produce, in the short term, an ambitious, one-size-fits-all roll-over, based on a "genuine restructure" type requirement, even if the GBRR is limited to a relatively small subset of current roll-overs. An ambitious GBRR framed in this way is likely to result in the very problems already identified by the Board with the SBRR being spread economy-wide and stifling business restructuring at least in the short term until the meaning of its principles is worked out by stakeholders. In the post-COVID environment, the need is for quick action to restart restructures in the widely held and large private sector.

In our submission, an alternative approach is, within the overarching policy framework outlined by the Board to guide the application of CGT roll-over provisions, to identify specific current problems that have a significant negative economic impact on business restructures and for which a legislative solution is required, and would be easier to achieve.

Some legislative changes are quite straightforward – they require no more than a clarification to reverse a number of interpretations placed by the ATO on the provisions (the kind of interpretations made public in TD 2019/D1 in March 2019 and finalised in TD 2020/6).

5 Plan B: selected policy changes that could be legislated quickly

5.1 Four key outcomes

We welcome the Model advanced by the Board and we would be sorry to see the project delayed – or worse, fail – for the reasons just examined.

Consequently, this section of the submission examines a less ambitious route to achieving what we regard as the four key improvements outlined in the Consultation Paper:

- restructures involving a sequence roll-overs (provided the relevant conditions are met);
- restructures where the relevant transactions are followed by a subsequent capital raising;
- restructures where the demerged entity is subsequently sold; and
- restructures which the “like-for-like” requirement would currently forbid.

We suspect these key improvements could likely be achieved by amending a handful of rules. No doubt legislative drafters will have their own views about how the outcomes might best be achieved but we venture to suggest this might be done by some or all of:

- amending the object clause in s. 125-5 and the terms of s. 124-775 to refer specifically to demerger or scrip-for-scrip transactions occurring in sequence, or these transactions followed by a takeover or capital raising (or vice versa);
- allowing the company to identify the scope of the ‘restructuring’ for the purposes of s. 125-70 and the ‘single arrangement’ for the purposes of s. 124-780 to identify which transactions are in and out of the restructuring;
- adjusting the proportionality test and the ‘and nothing else’ test in s. 125-70 to accommodate the situation which will occur if a demerger and a scrip-for-scrip transaction occur in sequence, or are followed by a capital raising or takeover.

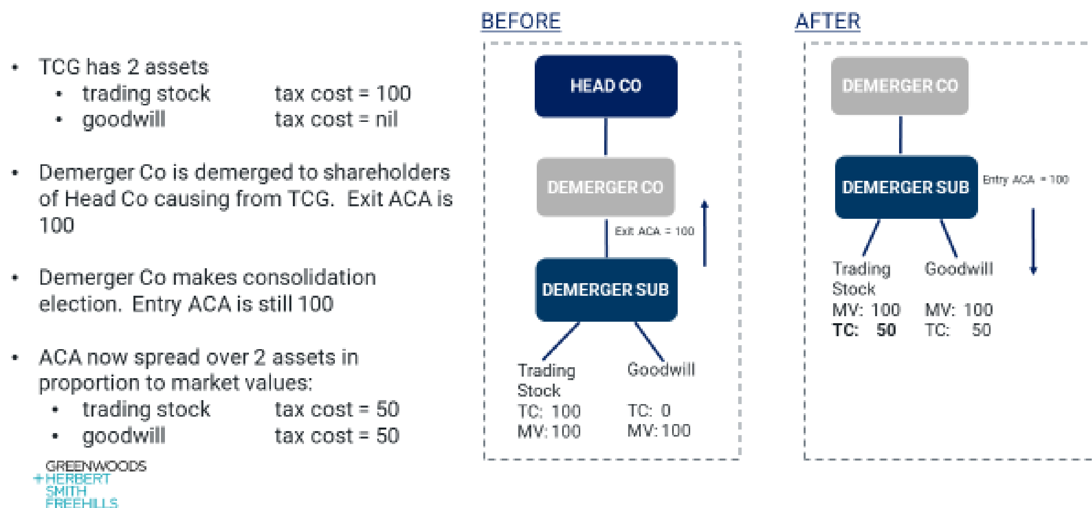
5.2 Further changes

We also note a few specific changes that would remove some of the impediments to M&A activity which currently exist, impediments which serve no obvious purpose (or do have a purpose, but one which is already dealt with by other processes).

(a) *Demergers*

In our submission, the consolidation cost base resetting rules in Div 705 and Div 711 should be amended to allow the demerged group to choose not to have the tax cost of its assets reset. There is ample precedent for switching off the consolidation cost base resetting rules where the impact is simply to re-shuffle the same cost figure among the same assets; the complexity and cost of the process is excessive. This is illustrated in Diagram 2.

+ Diagram 2 – Consolidation interactions



The amendments should also remove the application of CGT event L5 to a demerger.

Both these amendments were flagged by Treasury in 2010: Discussion Paper on tax relief for consolidated groups that undertake demergers.

(b) *Scrip-for-scrip rules*

At the moment, new scrip must be issued by head entity of an acquiring group because of s.124-780(3)(c). This provision can be especially problematic since it can require the scrip to be issued out of the ultimate holding company ***before*** the acquisition (a company which is now likely a subsidiary member). It also impedes transactions where the scrip-rollover is being used as the means for establishing a joint venture in some, but not all, of a group's operations. This rule serves no obvious integrity function. In our submission, it should be possible to issue scrip out of a subsidiary member of a group, not just the ultimate holding company.

The addition of s.124-780(2A) to exclude schemes of arrangement or takeovers which comply with Part 5.1 or Chapter 6 of the *Corporations Act* from having to satisfy the tests in s.124-780(2) ['… all owners … could participate' test and all can '[participate] on substantially the same terms'] was a welcomed improvement to the regime which benefitted listed entities. But the tests in s.124-780(2) still create problems for entities which cannot rely on s. 124-780(2A). There is clearly an integrity concern here which needs to be addressed, but it can be handled more simply and effectively by a market value test, currently in s. 124-780(5); this provision deals more than adequately with any potential value shift occurring as a result of the scrip transaction.

The Board's recommendation to remove the 'like-for-like' requirement in s.124-780(1) and s.124-781 should be implemented in current law.

Finally, the ATO still insists on treating a special dividend paid in the context of a takeover as both a dividend and as capital proceeds – see e.g., CR 2020/52. The ATO's Rulings will typically imply there is no double taxation because the 'capital gain … is reduced by the amount of the Special Dividend that is included in your assessable income under section 44 (section 118-20).' The statement is correct but incomplete; the real consequence of the ATO's position is that the taxpayer will lose any capital losses to the extent of the additional capital proceeds. There is double taxation, albeit in two steps. The ATO's approach is wrong conceptually – an amount is either the 'fruit of the tree' or it is 'proceeds of selling the tree'; for tax purposes, a single amount cannot be two different things at the same time. Division 116 should be amended to exclude any special dividend assessable under s. 44 from being capital proceeds.

5.3 Summary of legislative changes

Issue	Legislative change/policy statement	Priority
Demerger provisions – scope of the restructure	Amend s.125-70(1) to implement the proposal to allow scope of the restructure to either (i) be limited to transactions between the head company and its shareholders that effect the demerger; and/or (ii) exclude asset assembly steps within a tax consolidated group or transactions that result in a CGT event (for any taxpayer) that the head entity nominated for exclusions.	**High**
Demerger provisions – scope of the restructure	Amend s.125-70 to legislate proposed Condition 6(c)(ii) to allow demergers to qualify for demerger relief where undertaken in conjunction with a capital raising or take-over including scrip-for-scrip transactions. Amending the object clause in s. 125-5 and the terms of s. 124-775 to refer specifically to demerger or scrip-for-scrip transactions occurring in sequence, or these transactions followed by a takeover or capital raising (or vice versa)	**High**
Demerger provisions – cost base rules	Amend Div 705 / 711 to permit the tax cost of assets of a demerged group to remain at their current tax cost and not be re-set under Part 3-90. Amend CGT event L5 so that it does not occur when a demerger occurs.	**High**
Scrip-for-scrip provisions – like for like requirement removed	Amend s. 124-780(1) and s. 124-781 to implement the Board's recommendation to remove the 'like-for-like' requirement in current law.	**High**
Scrip-for-scrip provisions – ultimate holding company	Amend s. 124-780(3)(c) to allow new scrip to be issued by a subsidiary member of an acquiring group.	**Medium**
Scrip-for-scrip provisions	Use s.124-780(5)(a) [Model rule 2(c)] in lieu of the 'participation on substantially the same terms requirement' for all scrip-for-scrip transactions to address the possibility of value shifts.	**Medium**
Dividend and capital proceeds	Division 116 should be amended to exclude any special dividend assessable under s. 44	**Medium**

from being capital proceeds.

Also exclude a dividend that is assessable under s.44 from being “ineligible proceeds” under s.124-790.

6 Trusts

6.1 Incorporation bias

The Consultation Paper [p. 16] notes the incorporation bias in the current CGT roll-overs, some of which we have identified above. While no consultation question directly addresses this issue, the Board indicates that it wishes to understand the reasons for the bias. The Board raises the issue indirectly in questions 25-27 – why should widely-held trusts be treated so differently from widely-held companies. We consider that there are two underlying themes in this treatment.

Firstly, it has long been Australia’s policy that widely-held business activities should be conducted in corporate form as this significantly simplifies the taxation of income from the activities especially in an international setting where entity owners are partly or wholly offshore, but that widely-held collective investment activities should be taxed on the basis that the interposing of the investment vehicle does not significantly change the tax outcome for all investors in the vehicle. Both of these policies are reflected in the tax systems of Australia and comparable countries.

Secondly, for largely historical tax and non-tax reasons, from the 1970s discretionary trusts came to be the business and investment vehicles of choice for private or closely held (family-owned) income earning activities as this provided non-tax benefits (limited liability, protection of assets from family disputes) and tax benefits compared to the potentially penal taxation of income derived through closely held companies at the time (~45% company tax plus up to ~70% individual tax on dividends without any credit for the company tax, or ~30-50% undistributed profits tax on the company if the after-tax company profit was not distributed as dividends). The subsequent aggressive tax planning engaged in by private trusts meant that they were viewed with suspicion. Treasury and the Review of Business Taxation sought to counter this by recommending taxing trusts more generally as companies but this failed for political reasons and so the fall-back position was to view trusts with suspicion, for example, by not including them in the original CGT roll-overs.

In more recent times, it has come to be recognised that the suspicion is not justified for widely-held investment trusts used as collective investment vehicles; instead, any integrity concern is mainly a problem of closely-held, especially discretionary, trusts. Since the late 1980s a trend has developed of either creating bespoke trust roll-overs or extending new roll-overs to trusts (other than discretionary trusts) but keeping an incorporation bias in existing CGT roll-overs and even in new roll-overs. The most neutral roll-over treatment of trusts is in the SBRR which extends to discretionary trusts.

In our submission, it is time to consider removing the incorporation bias from the CGT roll-overs but because of the complex nature of the policies at issue outlined above, trying to do so through including trusts or a subset of trusts in the GBRR will further complicate its development and delay its implementation. Again, we consider that this should be done at least initially by way of specific amendments rather than through the GBRR. We outline our suggestions below.

6.2 AMITS [Questions 25-27]

Collective investment vehicles in the form of units trusts (nowadays mainly AMITs) form a significant part of the Australian widely held business and investment market, including a significant proportion of the ASX. In considering the review of CGT roll-overs, it is important that this sector is properly taken into account.

(a) *CGT event E4*

The Consultation Paper [p. 46] discusses roll-overs for AMITs and effectively raises two possibilities. The first is extending roll-overs which are limited to those trusts whose beneficiaries can be subject to CGT event E4 on the interests those beneficiaries hold (i.e., requiring a beneficiary to hold an interest or unit in the trust) to also include trusts in which CGT event E10 can apply to units held in those trusts, which provides equivalent but more elaborate treatment for AMITs. Such a change would deal with those existing roll-overs, such as Div 125 but not Div 124-M, where the E4 language is still used and extend the roll-overs to AMITs.

As trusts that have now elected into the AMIT regime previously qualified for these roll-overs but now do not, in our view this change would merely restore the status quo and is an obvious change to overcome an apparent oversight. With respect to the apparent oversight, it is incongruous with the policy of the AMIT legislation – which is clearly designed to encourage MITs to elect into the AMIT regime (via being deemed fixed trusts for the purposes of the Act, providing access to the 'unders and overs' regime, and allowing cost base uplifts under CGT event E10) – to then deny those same AMITs access to CGT roll-overs they previously could obtain due to CGT event E4 applying to them.

A more extensive change would make the trust test for Divs 124-M and 125 consistent by replacing the fixed trust test in Div 124-M with the CGT event E4 or CGT event E10 test we are recommending for Div 125. Experience with the fixed trust test has shown that it is almost impossible to satisfy for many widely-held trusts, and that was one reason why AMITs are deemed to be fixed trusts. The current result is that an AMIT can get Div 124-M treatment but not Div 125 treatment while many widely held trusts which are not AMITs can satisfy Div 125 but not Div 124-M. In our view this is also an accident of history and should be rectified.

(b) *Access to Div 126-B*

The second change contemplated by the Consultation Paper is to give AMITs the benefit of any GBRR that is developed and so further reduce the incorporation bias in existing law.

Under our preferred route of specific amendments in the short term the main roll-over that would give AMITs much more flexibility in their structure and so encourage business efficiency is Div 126-B for wholly owned groups of companies. This would allow, for example, elimination of complex sub-trust structures arising from acquisitions or legacy structures which had commercial reasons in the past but are no longer necessary. It would also be necessary to adjust other parts of the CGT regime for this change such as CGT event J1.

If it is thought that this change would encourage restructuring AMITs to enhance the utilisation of losses in the group, then an appropriate integrity rule could be introduced to forestall such activity benefitting from the roll-over (noting that the trust loss rules do not apply to capital losses). The inability to group losses within 100% commonly owned trust groups is another example of incorporation bias but is beyond the terms of reference of the current review. Otherwise tax integrity concerns are largely dealt with by the conditions for entering the AMIT regime particularly the regulatory regime for Managed Investment Schemes in the Corporations Act 2001 and the "clearly defined interests" test in Div 276.

We also note that there are no permanent tax difference outcomes to be obtained from roll-overs within AMIT structures (even where losses are utilised). The deliberate design

of the AMIT regime ensures cost base adjustments of membership interests in all circumstances purely track upward and downward movements in value of the unit over the income year because of attribution and distribution reflecting the value shifted out of the trust, and therefore, out of the unit. These cost base adjustment provisions under the AMIT regime specifically provide for an alignment of economic and taxation outcomes for unitholders.

6.3 Trusts satisfying CGT event E4

Similar issues arise in relation to trusts that satisfy the fixed trust definition or the CGT E4 test but not both. Typically a trust satisfying the fixed trust definition would satisfy the E4 test but not the other way around, Some of these may be able to elect into the AMIT regime but have chosen not to. At present, they can commonly utilise Div 125 roll-over but not Div 124-M nor Div 126-B roll-overs.

If the changes discussed under the AMIT heading above are made for aligning Divs 124-M and 125 around the E4/E10 definition this would automatically extend the treatment to qualifying trusts other than AMITs, unless the changes were specifically limited to AMITs. Alternatively to prevent the changes suggested above for AMITs creating tax incentives for trusts to enter the AMIT regime when otherwise it is not in their commercial interest, the change could be limited to other trusts which qualify for AMIT status but do not so elect.

In relation to Div 126-B roll-overs, similar changes could be made. As the extension of the Div 126-B roll-over is a more significant change it may in the first instance be prudent to limit the change to AMITs, or to trusts that are eligible to elect AMIT status whether or not they elect into the regime.

6.4 Superannuation trusts

Another important category of trusts in the Australian context is superannuation funds. They of course have their own tax regime and are not mentioned in the Consultation Paper. We note that some of the same problems for roll-overs in the CGT context also apply to superannuation roll-overs. In particular the fact that superannuation fund investments like managed investment trusts often have sub-trusts is not taken into account with the result that existing superannuation roll-overs for restructuring funds miscarry and are not available in many cases, for example, under ITAA 1997 Div 310.

6.5 Investment v business

In relation to trusts the issue that we have discussed above (section 3.3) of excluding investment activities which do not amount to a business will be more relevant due to the view that many trusts are unlikely to be in business. To the extent that any GBRR is extended to trusts, it will be important to ensure that there is not a general undefined business/investment line which determines whether the roll-over is available or not. This will lead to unproductive debate between taxpayers and the ATO on whether the roll-over is available. As noted above this issue should be dealt with clearly in the legislation whether executed by way of specific amendments to existing legislation or a new GBRR.