# KPMG submission

# *Review of CGT Rollovers – second consultation paper*

# Released December 2020

16 February 2021

cgtrollovers@taxboard.gov.au

Contacts: Grant Wardell-Johnson (+61 2 9335 7128)
Jenny Wong (+61 2 9335 8661)

# Executive Summary

KPMG welcomes the opportunity to comment on *the Board of Taxation's Review of CGT Rollovers* second consultation paper.

Our submission addresses all the questions in the Board of Taxation (the Board) consultation paper.

We highlight that Questions 10, 11 and 12 involve one of the most difficult questions in this Consultation. The analysis in this submission seeks to address what is the right economic result.

Overall, in most circumstances, the benefit of the market value uplift is not as great as many practitioners and revenue officers alike, believe. Nor is the detriment of the Simplified Push-up cost base proposal. This conclusion is enhanced when there is a time frame (say 12 months) placed around the rollover relief.

In addition to the comments above we would like to ask the Board to consider a corporate liquidation rollover where both:

- The taxpayer receives a replacement asset in exchange for giving up shares in a company such as upon liquidation of that company; and
- There is continuity of economic ownership of the underlying asset both before and after the restructure by the shareholders.

We have had feedback from a number of clients that such a roll-over would be beneficial and without integrity concerns. The analysis for such a proposal is outline in Appendix A.

# Detailed comments

## CGT Rollover

1) *Do you agree with this articulation of the benefits of a comprehensive, general restructure roll-over?*

Yes. The main benefit is that it would be founded on clear principles and outcome focused. This would allow the elimination of the multiplicity of slightly different conditions in the current list of rollovers. It would also reduce the current uncertainty that arises from the Commissioner seeking to ascertain the scope of a “restructure” to fit policy concerns in a somewhat difficult manner.

The common argument against the general business restructure rollover is that it would introduce uncertainty and that the alternative of applying specific rules (albeit tidied up) is preferable. Such an argument is not efficacious in the current uncertain environment as the ATO seeks to impose a “policy intent” over the provisions.

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

It would be easier to explain to non-tax specialists. It is likely to be practicable and not legalistic and not contain certain “traps” which are a feature of the current system.

3) *Should the general restructure roll-over be expanded to incorporate the functions of any other existing restructure roll-over?*

The general restructure rollover should be entity agnostic to the extent that the same underlying economic outcome is achieved and there are no other substantive integrity concerns. We agree with the analysis on the removal of the like for like requirement discussed below.

Existing rollovers focus on transferring assets ‘**into’** a corporate structure rather than ‘**between’** corporate structures (unless within a consolidated group). This disadvantages taxpayers that have a corporate structure in place as the tax cost of restructuring may be prohibitive. Such circumstances can arise when:

— There are multiple shareholders of a company who form different views around the objectives of the company, the best way to utilise its assets, its distribution policies.

— Companies have inherited legacy structures through acquisitions of non-100% interests and are unable to maximise their investment in assets not held directly.

— Under accounting standards, a company is unable to properly reflect its return on investment as non-controlling interests may be 'equity accounted' or accounted for as an 'investment'.

We would therefore encourage the Board to consider the expansion of rollovers to cover such situations where it fits within the same core design principles, being:

— That the fundamental design feature of CGT is the realisation basis for bringing capital gains to tax, such that CGT should apply when an asset is disposed of.

— That rollovers should be available to relieve inefficient 'lock-in' for business where there is strict continuity of economic ownership.

As such, a corporate liquidation rollover should be available where both:

— The taxpayer receives a replacement asset in exchange for giving up shares in a company such as upon liquidation of that company; and

— There is continuity of economic ownership of the underlying asset both before and after the restructure by the shareholders.

We provide some examples in **Appendix A** to demonstrate how this concept could apply and fit within the core design principles of both CGT and rollovers.

4) *Would the proposed approach outlined in Step 1 to define the relevant 'business restructure' provide greater certainty than the current regime?*

Yes. There is an illusion about the certainty of the current law when one considers the manner in which the Commissioner seeks to place a policy lens over the provisions (not necessarily without justification).

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

We suspect that the exclusion rule would not provide for different treatment for the same class of shareholders or unitholders (beyond their current rights to claim relief or not on a differential basis as in scrip for scrip). Although it is difficult to think of an example of how this might occur to the detriment of the Revenue.

6) *Do you have any suggestions relating to the roll-over election rules? Are they practical and could the requirements be further simplified?*

The features whereby the rollover applies when an election is made, but that is evidenced by the manner in which the return is lodged is simple and welcome. The feature for the exclusion of a party that does not agree with an otherwise all-in rollover is also welcome.

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

A 12-month rule from the first CGT Event, but subject to extenuating circumstances such as regulatory approvals, legal disputes etc that would have occurred within the 12-month period has the right balance of certainty and flexibility.

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'.*

On the suggested expansions (removal of like for like, interposed holding trust) we would agree that this is appropriate. It is difficult to see why a "narrowing" of the relief – such that it is not available where an entity becomes the owner but does not acquire 80% under the restructure scheme – would present practical difficulties.

The inclusion of scrip for scrip in the general rollover makes sense.

Disregarding de minimis share holdings is appropriate (although there may be clearer drafting than currently exists) and is welcome.

Also disregarding capital raisings post-rollover is beneficial.

Normal employee shares should receive treatment that encourages continued benefits of the scheme which may involve both rollover and being disregarded for determination of the underlying ownership tests.

A requirement that all owners be able to participate on substantially the same terms is not an unreasonable integrity provision.

The Board of Taxation second consultation paper provides that where a CGT event qualifies for both general business rollover and another specific CGT rollover, the Board considers as a broad rule, the specific CGT rollover should override the general rollover (p29). In addition, it provides relief would not be available under the general rollover where a specific rollover provision applies to a transaction or arrangement, but its conditions are not satisfied.

Specific rollovers enacted over the years can be prescriptive and in the event entities to transactions cannot meet the detailed criteria, but meets the general business rollover, which would otherwise meet the policy objective for which rollovers are available, then we cannot see a reason for precluding rollover relief from applying.

A better approach would be to firstly determine whether rollover is available under the specific rollover provisions and if not, then as a fall back the general rollover provisions applies as a last resort.

9) *Where the restructure involves only publicly listed groups, what modifications should be made to further streamline the eligibility conditions?*

Some requirements may not be required because they are likely to happen in any event (eg. the requirement to participate on substantially the same terms). That said there is considerable benefit in having one set of rules.

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

See Answer to Question 12.

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

See Answer to Question 12.

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

**Example - Scrip for Scrip Rollovers**

Questions 10, 11 and 12 involve one of the most difficult questions in this Consultation. The analysis below seeks to show light on the issue by asking what is the right economic result. A detailed spreadsheet accompanies this analysis. The conclusion is that the benefit of the market value ‘step up’ is not as great as many believe, nor is the ‘detriment’ of the simplified push-up.

With some background observations that seek to set the scene, the analysis asks what is the source of value in the “step up”. For the most part any value uplift that is not economically based and might be seen as an undue benefit is likely to be mitigated by taxation at another level.

The simplified step up has its own internal tensions as outlined below.

1 The current rules essentially involve three buckets in determining the cost base of the shares in the Original Company held by the Acquiring Company. The first is a Significant or Common Shareholder bucket where the interests matching the Significant or Common shareholders receive a transferred cost base and the remainder receive a market value cost. The second bucket is where there is a Restructure (or Top hat) which involves a “simplified push-up” of tax cost from assets to the Acquirer’s shares in the Original Company (which includes the value of assets without a tax cost). The third bucket is residual with largely ‘widely held’ shares and no Significant or Common Shareholders or a Restructure. This residual category involves a market value cost base.

2 This raises the inter-related questions of costs of compliance and what is the economically most sensible outcome. Most would agree that using a cost transfer basis for widely-held shares is impracticable. That leaves three possibilities (or a combination of these), leaving aside a more complex tax cost push-up.

- Cost transfer for Significant or Common shareholdings;
- Market value for widely-held shareholdings;
- Simplified tax push-up (which excludes unrealised gains, except possibly goodwill).

3 It is noted that market value will commonly be above cost, but this is not inevitably the case. Shareholders in the Original Company may have purchased shares at many different times. It is also noted that if there are Significant and Common shareholdings as well as widely held shares, the benefit of the market value cost if it

exceeds cost is shared by all shareholdings in Acquisition Co and the *relative* detriment of the cost transfer for the Significant and Common shareholdings is borne by all new shareholdings in Acquisition Co.

4 Assuming there is an uplift from cost to market value, the question arises as to the source of that value uplift. In broad terms there are four potential categories.

5 Category I uplift in value arises from the growth of the business of Original Company over time from the date of the purchase of the Original shares to the date of the scrip for scrip and is reflected in the increased size of the tax asset base. These would involve realised and taxable profits at the level of Original Company. They can be split between the value that arose prior to the purchase of the Original shares (reflected in the cost of those shares) ("Category IA") and the value that arose after the purchase which is not reflected in the cost ("Category IB"). both Categories IA and IB would be reflected in the tax cost arising from a Simplified Push-up calculation.

6 Category II reflects the *value* of goodwill in Original Company. If the value of the goodwill (without a tax cost) arose prior to the purchase of Original shares then it will be reflected in the cost of those shares (Category IIA), but not if it arose after the purchase (Category IIB). In both cases it is part of the Simplified Push-up.

7 Category III reflects an increase in value above cost of unrealised assets over time (including goodwill with a tax cost). To the extent that this occurred prior the acquisition of the Original shares by Original shareholders (Category IIIA), it will be reflected in the cost of the purchase price of the shares, however, it will not be part of the Simplified Push-up calculation. To the extent that the value accrued after purchase (Category IIIB) it will be reflected neither in the original cost not the Simplified Push-up.

8 Category IVA is the increased value of the shares in Original Co as a result of expected synergies from the takeover or merger. It is part of the new group value. This is not reflected in a Simplified Push-up. Category IVB is similar, but where that

value arises from an expectation of better management or other factors which will effect the value of the Original company and its assets, but is not synergistic in nature. Neither of theses categories will be reflected in the Simplified Push-up calculation.

9 An analysis of the various Categories, together with how they are reflected in tax cost after the scrip for scrip, various mismatches and the potential for double tax is outlined in the attached Appendix as well as some Observations.

10 Our overall conclusions on the mismatch are as follows:

- There are four categories where the Market Value and the Simplified Push-up match in relation to the market value cost base transfer of the shares in Original Co by Acquirer after the scrip for scrip. They are where the source of uplift in value is due to the growth in business which reflects growth in asset base and realised profits (Categories IA and IB) and where there is growth in the value of goodwill without a tax cost (Categories IIA and IIB).

- There are four categories where there is a mismatch between a market value cost base and a Simplified Push-up. One of those presents an economic disadvantage for the Simplified Push-up and that is where the value accruing to unrealised assets accrued before the purchase of the original shares (Category IIIA). It would be included in the cost of the Original shares and not in the Simplified Push-up.

- By way of contrast where the value accrued after the original purchase it is included in the market value transfer but not in the Simplified Uplift (Category IIIB). Considered entirely in isolation this is an economic benefit. However, this benefit may be reduced by taxation both at the level of the Acquirer shares and any asset disposals by Original Co post scrip for scrip.

- Where there is an increase in value of the Ordinary shares prior to the scrip for scrip based on the expectation of future synergies from the merger (Category IVA) then the market value transfer provides a prima facie benefit both against the Simplified Push-up and what might be seen as the economic result. However, two factors dissipate this. The first is that such synergistic benefits (largely) would not lie in value of the Original shares or its assets post scrip for scrip and so is unlikely to be realised. Secondly, taxation at the level of shares in Acquirer and the tax assets of Original would dissipate this benefit.

- Where there is an increase in the value of the Ordinary shares prior to the scrip for scrip due to an expectation of non-synergistic elements such as better management of Ordinary Co post acquisition (Category IVB), then there is also a *prima facie* benefit against both the Simplified Push-up and the economic position. That value could be realised at the sale of Original Co. However, this would be mitigated by the sale of any shares in Acquirer.

11 Double taxation occurs in many environments where there are layers of companies. Given that, it does not seem to be a justification in its own right for an uplift to market value, but what it does do is mitigate the effect of a *prima facie* economic benefit as tax is likely to be picked up at a different level and especially a higher level – Acquirer.

12 Overall, in most circumstances, the benefit of the market value uplift is not as great as many practitioners and revenue officers alike, believe. Nor is the detriment of the Simplified Push-up. This conclusion is enhanced when there is a time frame (say 12 months) placed around the rollover relief and it is not taken purely in isolation.

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

With the comments above born in mind, the consequences of the general rollover do not produce an unreasonable result.

Consideration will need to be given to the interaction with the tax consolidation provisions in relation to the asset's cost base.

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

Yes. As noted above the Simplified Push-up presents a tension where there are assets with a CGT cost-base (assets with an inherent gain in value) and value for CGT assets without a cost base (goodwill).

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. 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?*

There are clearly commercial drivers which give rise to a mixture of cash and scrip consideration in many settings. To deny partial rollover relief in this environment would result in tax driving the transaction. The additional complexity should be easily accommodated.

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?*

None come to mind.

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?*

The most valuable feature is that it is outcome focused and, for the most part, not focused on the form of the series of transactions.

The other important feature is that it will simplify the CGT rollover regime.

With clear drafting this will provide certainty and common-sense outcomes understood by non-tax specialists.

18) *What constraints should be put in place on the availability of roll-over where a capital raising has occurred?*

None, except where the capital raising had features that were contrived and became a substitute for a sale then Part IVA would be available. Whilst a feature of the principles underlying a rollover are that the economic owners remain the same, that cannot be viewed as the position for all time. The very raison d'etre for the roll-over is that the demerged entity can make a greater economic contribution on its own. If that contribution is supported by a capital raising (even contemplated in conjunction with the demerger) it does not present an integrity risk by itself. As is noted various businesses have different costs of equity capital and the demerger provisions should reflect the benefits of the added efficiency for structures that recognise this. To do otherwise locks in an inefficiency.

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

This would occur where the arrangement is a synthetic sale and the natural basis of the arrangement would be a sale of shares to new third party investors. This should be dealt with at the level of a general anti-avoidance provision.

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

No. This would add unwarranted complexity for a theoretical benefit.

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?*

Yes. For example, a scrip for scrip rollover on a takeover or scheme of arrangement leading to a larger group could be followed by a capital raising with a cheaper cost of equity given the additional size and business plans of the merged entity. The CGT rollover should facilitate this and not seek to act as an impediment.

A capital raising should generally be seen in a positive light on the basis that people are willing to invest in a modified business structure for commercial reasons. The fear of the disguised sale can be over-rated.

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

Yes. Covid-19 has given rise to a significant number of businesses needing to rethink their future. This rethinking is beyond the normal business environment with many positive and negative experiences. In some cases, there will be benefits in merging and demerging heightening the need for flexible CGT rollovers.

If there is a balance to between raising revenue and adjusting policy settings to promote economic growth, the focus should be on the promotion of economic growth. This is the best path to repaying government debt that has (appropriately) been the consequence of Government's response to the crisis.

23) *Would you support a general rule that assets received by way of replacement for pre-CGT assets with a market cost base?*

Yes. The nature of the grandfathering of pre and post CGT assets with the introduction of the CGT regime was naturally distortive with unfortunate lock-in impacts and little foundation in equity. This would contribute to undoing this, although arguably it has its own lock-in dimensions. Balance should favour undoing pre-CGT status.

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

Use the rule in Section 124-M is simplest. The pre-CGT status is lost and the replacement asset becomes a post-CGT asset with a market value cost-base.

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?*

Yes. The failure to include E10 in the same manner as E4 would appear to be a simple policy oversight. Economically, there is benefit in providing the additional flexibility.

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

Most commonly for synergistic mergers based on asset and cost synergies.

27) *Would giving AMITs access to general roll-over be inconsistent with the requirement for an irrevocable decision to enter the AMIT regime?*

No. The potential to "undo" an irrevocable election, would appear to be a theoretical and minor concern.

28) *What implementation issues should be taken into account in extending relief in this way? That is extending the Division 615 relief for trading stock and revenue account scrip to other general rollovers.*

A simple extension of the rollover relief rules to trading stock and revenue assets would need to be drafted appropriately, but the cost and distortion occurs in not extending the relief in the manner proposed.

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

None that we are aware of.

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

We agree that the removal would not and should not allow for streaming and the comments in relation to discounted capital gains.

31) *Should the policy surrounding the application of business restructure rollover relief to arrangements involving consolidatable groups be revisited?*

Yes.

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

The immense complexity of specific integrity issues designed to address potential double benefits in loss scenarios are not worth the cost. This should be left to Part IVA to deal with specific schemes.

33) *Would there 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?*

Not addressed.

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

## Other comments – potential corporate liquidation rollover

In addition to the comments above we would like to ask the Board to consider a corporate liquidation rollover where both:

The taxpayer receives a replacement asset in exchange for giving up shares in a company such as upon liquidation of that company; and

There is continuity of economic ownership of the underlying asset both before and after the restructure by the shareholders.

We have had feedback from a number of clients that such a roll-over would be beneficial and without integrity concerns. The analysis for such a proposal is outline in Appendix A.

## *Appendix A*

As acknowledged by the Board, the importance of business restructures will increase as companies look to recover in a post-COVID-19 world. Flexibility and simplicity within the tax legislation to allow for business restructures will be crucial to enable efficient and effective reorganisations and rationalisations. In that context, we request that the Board considers an additional category of rollover to enable corporate liquidations that are both a natural extension of existing rollovers and fit within the same core objectives and principles.

We acknowledge that the primary focus of the review is to simplify existing CGT rollovers into a general rollover that has 'substantially similar practical effect'. However for the reasons set out below, we consider a corporate liquidation rollover to be equally important as simplification to provide businesses with more flexibility to restructure to assist with their post-COVID-19 economic recovery.

### *Corporate liquidation rollover*

A key feature of Australia's existing CGT rollovers is the ability to transition between business structures without tax being an impediment. Subdivisions 122-A, 122-B, 124-N, 126-B, 126-G and 328-G as well as tax consolidation, all provide a rollover for the transfer of assets between particular structures, giving taxpayers the freedom to restructure their interests without tax being an impediment to doing so.

Existing rollovers focus on transferring assets '**into'** a corporate structure rather than '**between'** corporate structures (unless within a consolidated group). This disadvantages taxpayers that have a corporate structure in place as the tax cost of restructuring may be prohibitive. Such circumstances can arise when:

- There are multiple shareholders of a company who form different views around the objectives of the company, the best way to utilise its assets, its distribution policies.
- Companies have inherited legacy structures through acquisitions of non-100% interests and are unable to maximise their investment in assets not held directly.
- Under accounting standards, a company is unable to properly reflect its return on investment as non-controlling interests may be 'equity accounted' or accounted for as an 'investment'.

We would therefore encourage the Board to consider the expansion of rollovers to cover such situations where it fits within the same core design principles, being:

— That the fundamental design feature of CGT is the realisation basis for bringing capital gains to tax, such that CGT should apply when an asset is disposed of.

— That rollovers should be available to relieve inefficient 'lock-in' for business where there is strict continuity of economic ownership.

As such, a corporate liquidation rollover should be available where both:

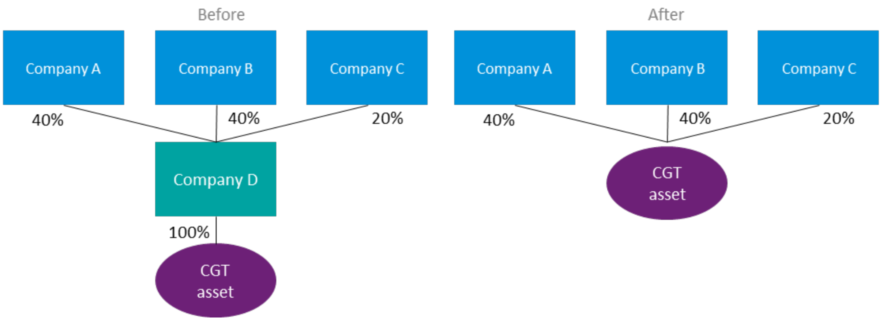
— The taxpayer receives a replacement asset in exchange for giving up shares in a company such as upon liquidation of that company; and

— There is continuity of economic ownership of the underlying asset both before and after the restructure by the shareholders.

### *Example*

We provide the following example to indicate how this concept could apply and fit within the core design principles of both CGT and rollovers.

Company D has 3 shareholders.  Circumstances have changed over time such that there is no longer common agreement on the activities of Company D and how it should best utilise its CGT assets and the profits derived thereon.  The shareholders agree to liquidate Company D and a result in exchange for the cancellation of shares receive a direct interest in the underlying CGT asset.




In the absence of an expanded scope of rollovers, the following tax outcomes would arise even though there is no change in the underlying interests in the CGT asset.

— Company D would realize a capital gain/loss on the disposal of the CGT asset.

— Company A, B and C would realize a capital gain/loss on the disposal of the shares in Company D and receive a dividend to the extent the distribution is not debited to share capital.

Under this example, the tax cost arising from the above is likely to prohibit the restructure from occurring which limits the flexibility of shareholders from ensuring their business is structured efficiently and the assets they ultimately own are being utilized as effectively as possible to maximize economic returns.

### *Structure of the rollover*

The structure of the corporate liquidation rollover would allow for:

- Any capital gain or loss on the transfer of the CGT asset (the replacement asset) to shareholders is disregarded by the company being liquidated;
- The cost base of the CGT asset in the hands of the shareholder is worked out by reasonably attributing the cost base of the original asset (i.e. the shares) to the replacement asset (i.e. the underlying CGT asset distributed to shareholders).
- The cancellation of shares in the company being liquidated does not result in a capital gain or capital loss to the shareholder.
- There would be no change to the income tax consequences to the shareholder as prescribed under the Act.

Such rollover should also be automatic (consistent with the proposal for scrip-for-scrip transactions noted in section 4.2 of the Board's second consultation paper).

This rollover therefore neatly fits within the terms of the rollover model set out in section 4 of the Board's second consultation paper with minimal disruption or unintended impact. This can be demonstrated through worked examples of the fact pattern set out in the example above.

*Scenario 1a* – The only asset of Company D is a CGT asset with a cost base of $100 and a market value of $1,000. The shares in Company D are also worth $1,000 and the shareholders have the following cost bases for their shares in Company D.

| **Company** | **A** | **B** | **C** |
|---|---|---|---|
| Cost base for shares in Company D | $200 | $200 | $50 |

Company D is liquidated, and all parties choose to apply the rollover. As such:

- All capital gains are disregarded.
- The cost base of the CGT asset in Company D's hands is effectively disregarded.
- The cost base of the shares in Company D of Company A, B and C is attributed to the replacement CGT asset they receive as follows:

| Company | A | B | C |
|---|---|---|---|
| Cost base for replacement CGT asset | $200 | $200 | $50 |

This results in an increase in the cost base of the underlying CGT asset from $100 in the hands of Company D, to a combined cost base of $450 in the hands of Company A, B and C. This is considered to be fair and equitable because:

- The $450 reflects the transfer of A, B and C's existing cost base for the shares in Company D to the underlying asset (i.e. it reflects their historical 'cost' of the asset and it would be inequitable for their 'cost' to be reduced).
- Company A, B and C always had the flexibility to sell their shares in Company D rather than have Company D sell the underlying CGT asset. That is, the cost base of the CGT asset to Company D may never have been relevant as based on the facts set out above, it may never have been directly sold.
- The opposite outcome could arise where Company D's cost base is higher than the shareholders (see scenario 1b below).

*Scenario 1b* – The only asset of Company D is a CGT asset with a cost base of $800 and a market value of $1,000. The shares in Company D are also worth $1,000 and the shareholders have the following cost bases for their shares in Company D.

| Company | A | B | C |
|---|---|---|---|
| Cost base for shares in Company D | $200 | $200 | $50 |

Company D is liquidated, and all parties choose to apply the rollover. As such:

- All capital gains are disregarded.
- The cost base of the CGT asset in Company D's hands is effectively disregarded.
- The cost base of the shares in Company C of Company A, B and C is attributed to the replacement CGT asset they receive as follows:

| Company | A | B | C |
|---|---|---|---|
| Cost base for replacement CGT asset | $200 | $200 | $50 |

This results in a decrease in the cost base of the underlying CGT asset from $800 in the hands of Company D, to a combined cost base of $450 in the hands of Company A, B and C.  No benefit arises in this scenario as the cost base of the underlying CGT asset is reduced.

*Scenario 2a* –Company D owns a CGT asset with a cost base of $100 and a market value of $1,000, as well as holding revenue/depreciable assets with a written down value and market value of $900.  The shares in Company D are worth $1,900 and the shareholders have the following cost bases for their shares in Company D.

| **Company** | **A** | **B** | **C** |
|---|---|---|---|
| Cost base for shares in Company D | $200 | $200 | $50 |

Company D is liquidated, and all parties choose to apply the rollover.  As such:

— All capital gains are disregarded.

— The cost base of the CGT asset in Company D's hands is effectively disregarded.

— Company A, B and C attribute the cost base of their shares in Company D to the replacement CGT asset they receive in line with the table below.  In this scenario, the cost base for the shares needs to be apportioned as the shareholders are also receiving the revenue/depreciating assets.  As the CGT's cost base is $100 and the written down value of the revenue/depreciable assets is $900, a reasonable attribution of the shareholder's cost base would be 10% (being $100 / $1,000).

| **Company** | **A** | **B** | **C** |
|---|---|---|---|
| Cost base for replacement CGT asset | $20 | $20 | $5 |

This results in a decrease in the cost base of the underlying CGT asset from $100 in the hands of Company D, to a combined cost base of $45 in the hands of Company A, B and C.  No benefit arises in this scenario as the cost base of the underlying CGT asset is reduced.

*Scenario 2b* - Company D owns a CGT asset with a cost base of $100 and a market value of $1,000, as well as holding revenue/depreciable assets with a written down value and market value of $50.  The shares in Company D are worth $1,050 and the shareholders have the following cost bases for their shares in Company D.

| **Company** | **A** | **B** | **C** |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Cost base for shares in Company D | $200 | $200 | $50 |

Company D is liquidated, and all parties choose to apply the rollover. As such:

- All capital gains are disregarded; and
- Company A, B and C attribute the cost base of their shares in Company D to the replacement CGT asset they receive in line with the table below. In this scenario, the cost base for the shares needs to be apportioned as the shareholders are also receiving the revenue/depreciating assets. As the CGT's cost base is $100 and the written down value of the revenue/depreciable assets is $50, a reasonable attribution of the shareholder's cost base would be 33% (being $100 / $150).

| **Company** | **A** | **B** | **C** |
|---|---|---|---|
| Cost base for replacement CGT asset | $67 | $67 | $16 |

*This results in an increase in the cost base of the underlying CGT asset from $100 in the hands of Company D, to a combined cost base of $150 in the hands of Company A, B and C. This is considered to be fair and equitable for the same reasons as scenario 1a above.*

### *Proposed changes to the general rollover*

Based on the current drafting, the proposed corporate reconstruction rollover set out above would not qualify due to the requirements in subpart 2(b)(ii) and (iii) in section 4.1 of the second consultation paper that require each 'replacement asset' to be an 'ownership interest in a company'. These requirements reflect the terms of existing rollovers regarding transferring assets into a corporate structure however does also limit business flexibility as it means corporations can be 'locked in' to corporate structures in circumstances where they do not hold 100%.

There is therefore an opportunity with the current review to address this limitation through a slight expansion of the regime. This could be enabled by modifying the requirements of the 'replacement asset' such that it contemplates that a CGT asset can be the 'replacement asset'.

This could be done by aligning the requirements of the 'replacement asset' with the requirements of the 'original asset'. That is, it can be either an 'ownership interest' or a 'business asset' rather than being limited to being 'ownership interests'.

The remaining model terms of the general business rollover achieve the objectives of the proposed corporate reconstruction rollover detailed above and include sufficient integrity measures to prevent abuse or unintended outcomes.  Specifically (by reference to the sections of the second consultation paper):

- Subpart 1(e) of section 4.1 ensures that the restructure must have a dominant commercial purpose.
- Subpart 6(c)(i) of section 4.2 ensures that the rollover only applies where there is no change in the ultimate economic ownership of the CGT asset.
- Section 4.3 provides for the deferral of capital gains and losses and determination of cost base for the replacement asset.
- Subpart 8 of Section 4.2 provides for sufficient integrity measures to ensure that taxpayers cannot transfer assets out of a corporate structure into a tax advantaged entity without appropriate CGT outcomes arising on the transfer.

### *Comparison to other tax regimes and rollovers*

As final support for the above proposition, we note that there are many precedents both in Australia and around the world that allow for rollovers such as this.  The most notable being as follows:

- *Subdivision 328-G (small business restructure rollover)* – In acknowledgement that the most appropriate structure for a small businesses may change over time, Subdivision 328-G was enacted in 2016 to provide small businesses to defer capital gains on business restructures where there is no change in economic ownership.
- *Subdivision 40-363 (interest re-alignment arrangements)* – Created in 2015, section 40-730 provides resource companies to exchange or combines parts of mining/petroleum interests where they relate to the same overall project.  This provided significant flexibility to the resource industry to restructure interests to promote the investment and development of assets and projects.
- Stamp Duty – Both Western Australia and Tasmania have provisions within their legislation that allow for relief on a voluntary liquidation.  A general rollover that encompasses the corporate reconstruction / liquidation rollover set out in this paper would therefore assist with aligning rollovers between income tax and Stamp Duty regimes, giving both greater simplicity in frameworks as well as providing greater flexibility to organizations on restructuring their business interests.

It is also important to acknowledge that many countries around the world have significantly more flexibility with regard to business restructures and rollovers.  For example, Canada's amalgamation rules and the US tax rules on liquidations provide significantly flexibility allowing organisations to restructure their business assets to maximize their efficiency and utilisation. Whilst individual countries have their own policy and tax considerations that influence that, the existence and commonality of rollovers of this nature indicates the importance they have in the business landscape.