



Australian Government

The Board of Taxation

REPORT INTRODUCING AN ASSET MERGER ROLL OVER RELIEF

A Report to the Treasurer

the **board** of taxation
www.taxboard.gov.au

The Board of Taxation
February 2017

Report introducing an asset merger roll over relief

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EXECUTIVE SUMMARY

The Board of Taxation (the Board) recommends that the Government introduce an optional roll-over which defers tax liability for the disposal of a company's interests in assets in a merger with interests in assets of another company and for asset for scrip mergers between companies. The relief would apply to the disposal of 'active' capital gains tax (CGT) and depreciating assets which are contributed to an ongoing economic enterprise as part of a merger/business combination transaction. The relief would not be a permanent deferral of tax liability. The tax liability would crystallise at the time the company disposes of their interest in the merged business or the merged business disposes of the rolled over assets.

The deferral should apply to the extent to which the taxpayer does not receive cash. That is, a partial roll-over should be available where consideration other than an interest in the merged business is received. The deferral should not be available in relation to:

- a final disposal/realisation of assets (cash-outs and/or reinvestment in new assets unrelated to the merged business activities);
- divestment or wind-up of a business;
- the rolling of business assets outside the Australian tax net (where the purchaser would not be subject to tax in Australia on a subsequent sale of those assets); or
- an "asset-swap" that is the exchange for a 'like-kind' asset unrelated to the merging of activities.

In the Board's view, such a deferral would be a sound policy initiative to drive the Government's policy objectives of stimulating jobs and growth by generating economic activity. It will facilitate combinations and mergers of active business assets that may not otherwise occur in the absence of roll-over relief. It will also unlock synergistic value for both companies and the potential for growth resulting in more profitable and viable Australian businesses.

The Board is of the view that the proposed roll-over fits within the policy parameters of the broader income tax and CGT regime to tax gains and income on realisation.

CHAPTER 1: INTRODUCTION

BACKGROUND

In January 2016, the Treasurer requested that the Board submit ideas that could be announced in the 2016-17 Budget in line with the Government's plan to establish a strong national platform for jobs and growth.

In response, the Board submitted that the Government should 'remove barriers to efficiency-driven non-cash business asset merger or swap restructures by providing income tax roll-over deferral relief'. The Treasurer's reply requested that the Board explore a proposal for asset swap and merger roll-over relief.

In particular, the Treasurer requested that the Board consider technical and implementation issues that would need to be further examined, including the characterisation of assets, substantial interest requirements and the absence of stamp duty relief which could impact on the proposal's success.

This report is in response to that request.

REVIEW PROCESS

Working Group

1.1 The Board appointed a Working Group to develop this proposal. This Working Group was chaired by Board member Ann-Maree Wolff with assistance from Board member Craig Yaxley.

1.2 The Working Group also included:

- Tax professionals with expertise in large business taxation, in particular Cameron Rider (PwC) and Ken Spence (Herbert Smith Freehills).
- A tax professional with expertise in State and Federal taxation interactions, in particular Michael Perez (King & Wood Mallesons).
- A tax professional with expertise in small business taxation, in particular Mark Molesworth (BDO).
- Officials from Treasury and the Australian Taxation Office.

Consultation

In formulating its advice, the Board conducted consultations to determine the potential benefits and level of interest in the proposed measure. The Board's consultations comprised meetings with and input from the following organisations:

- Australian Petroleum Production & Exploration Association ('APPEA').
- Australian Private Equity and Venture Capital Association Limited ('AVCAL').
- Business Council of Australia ('BCA').

- Chartered Accountants in Australia and New Zealand ('CAANZ').
- Corporate Tax Association ('CTA').
- Minerals Council of Australia ('MCA').
- National Farmers Federation ('NFF').
- Boyce & Co (an accounting firm with expertise in taxation of rural businesses retained by the Rural Industries Research and Development Corporation to report on tax in the agriculture industry).
- The Tax Institute.
- Stakeholders in the manufacturing industry.

FEEDBACK FROM THE BOARD'S CONSULTATION

1.3 A summary of feedback from the Board's consultation is attached at Appendix A.

1.4 Consultation participants were supportive of the concept of an optional roll-over for certain types of asset merger transactions with some specific industries particularly supportive (refer below). Participants confirmed that the existing law does not facilitate some commercially viable merger/business combination transactions due to the tax costs involved or the tax risks and commercial complexity involved in structuring transactions to seek access to existing roll-over relief provisions or to otherwise mitigate the tax costs of the transaction. It was suggested that the Board take the opportunity to clarify and resolve overlaps between existing roll-overs (especially scrip for scrip roll-over) and between existing roll-overs and any new roll-over under these proposals.

Alternative approaches to facilitate 'merger' transactions in a synthetic fashion for example, economic or synthetic joint ventures and joint management contractual agreements are commonly considered with a view to effecting similar business combination outcomes. Participant's noted that these alternatives are generally problematic due to the difficulty in these structures meeting commercial objectives, the tax risk associated with the synthetic structures, the high risk of relying on contractual rights (as versus ownership interests) and associated ongoing legal and accounting complexity.

Participants were of the view that facilitating business merger transactions would result in an increase in economic activity and improve the profitability and economic efficiency of the merged assets/combined businesses. In particular, consultations revealed that additional roll-over relief would facilitate commercial transactions in the following industries:

- mining;
- oil and gas;

- manufacturing including steel and industrial chemicals;
- agriculture; and
- the digital economy.

1.5 Many of the businesses in these sectors are facing challenges as a result of geographic constraints, declining profitability due to falling commodity prices or changing consumer consumption patterns. The drive to consolidate the capacity in these industries to achieve economies of scale has been discouraged by substantial tax costs or significant tax risks.

The consultation indicated that business combinations/mergers via direct asset ownership may not be the preferred commercial ownership structure for many business types. In order for the roll-over to be most useful, its scope should be extended to include mergers involving shares, such as where an asset is contributed in return for shares in a company. Facilitating transactions of this type may also mitigate stamp duty costs on transactions given the nature of relevant regimes in some states.

The issue of stamp duty costs was raised directly and consultees indicated that the removal of stamp duty on business combinations would significantly assist in enabling these transactions to proceed, particularly in the resources sector. Whilst participants encouraged the Government to facilitate discussions with the States and Territories to remove stamp duty on these transactions, the feedback did however indicate that an income tax roll-over would facilitate more transactions of this type even where stamp duty relief is not available.

Participants indicated that consideration is generally given to the scope to achieve an effective merger of businesses held via a company through a combination of existing roll-overs, especially scrip for scrip roll-over in Subdivision 124-M of the *Income Tax Assessment Act 1997* via sequenced transactions. However, the intended scope of scrip for scrip roll-over is limited, and the ATO typically ascribes a high risk rating from either a technical or tax avoidance perspective to transactions that involve back-to-back roll-overs (which are required to fully affect a merger outcome).

1.6 Consultations undertaken by the Board support the inclusion of integrity measures. These include the exclusion of any cash component from the roll-over and requiring the parties to continue to hold an ownership interest which results in economic exposure in the combined/merged business. The Board is very much aware of the importance of integrity measures in relation to this measure. As such, the Board stresses that addressing major integrity risks should be regarded as a critical component of the further development of this proposed roll-over relief measure and has therefore addressed potential approaches to managing integrity risks in its policy and legislative recommendations.

BOARD'S REPORT

The Board considered the comments at consultation meetings and the views of the members of the Working Group, Treasury and the ATO. However, the Board's recommendations reflect its independent judgment.

All legislative references in this Report are a reference to either the *Income Tax Assessment Act 1936* (1936 Act) or the *Income Tax Assessment Act 1997* (1997 Act), unless otherwise stated.

CHAPTER 2: THE BOARD'S ANALYSIS AND RECOMMENDATIONS

RATIONALE

1.7 Business merger transactions provide the means through which two or more entities combine their assets for the purposes of creating a combined business which provides access to higher combined profitability or economic benefits. These benefits may arise from economies of scale, joint access to infrastructure, improved efficiency, enhancing international competitiveness, facilitating greater levels of investment or improving the viability of the businesses that otherwise may be at risk of failure.

1.8 Feedback from the Board's consultations indicate that there are situations where economically sensible business mergers are not taking place because of the income tax cost involved¹ or due to the tax risk and complexity involved in structuring the deal in a tax-effective way. Further, feedback suggests that resources are expended in exploring alternative approaches in the hope of being able to facilitate 'merger' transactions that utilise economic or synthetic joint ventures as a means to address the income tax cost but which are often unsuccessful due to the resulting tax risk and commercial/legal/accounting complexity.

1.9 The current tax law provides some roll-over relief from CGT that would otherwise be payable due to a change in ownership of the assets. For example, scrip for scrip CGT roll-over relief is available for takeovers and mergers involving companies or trusts. If shares or trust interests are exchanged for similar interests in another entity in a takeover or merger, the scrip for scrip roll-over defers a capital gain on the disposal of the scrip until the disposal of the replacement scrip. Roll-over relief is provided because the shareholder's interest has merely been replaced not extinguished and continues in the takeover company. In this way the relief reduces the cost of takeovers/mergers as the acquiring entity need not compensate the holders of scrip for the CGT they would otherwise immediately have had to pay on the exchange, given that roll-over relief defers this tax impost. Thus tax does not stand in the way of economically sensible business reorganisations.

1.10 This roll-over relief has traditionally been provided on the basis that the cost base of the assets does not change through roll-over. If the transaction is wealth generating, the tax ultimately collected is greater since the original cost base is retained. A discussion of the current arrangements for roll-over relief more broadly is discussed later in this chapter.

¹ Feedback during the Board's consultations is that many asset merger proposals indicate strong pre-tax net present value for the business but fail internal hurdle rates when upfront tax costs are included.

1.11 However, scrip for scrip relief is limited² to mergers which occur by way of exchange of shares or trust interests and does not cover many of the situations where synergistic value can be created from merging businesses at the asset level.

1.12 The Board notes that providing roll-over relief of the kind proposed is an exception to the principle that a change in economic ownership is a natural taxing point. However, where there are economic benefits from facilitating a deferral of tax, roll-over relief has been included in the ITAA³. The Board is of the view, taking account of the feedback from consultation, that there are two types of asset merger transactions which do not currently benefit from roll-over relief in the ITAA and where it would be sensible to provide a deferral of income tax liability to drive economic activity:

- asset merger combinations; and
- asset for scrip mergers.

1.13 Under the current law, neither qualifies for existing roll-over relief (except in respect of a very narrow category of assets – refer below) and there are situations where facilitating these business combinations will enhance economic outcomes compared to the counterfactual of doing nothing and a merger not proceeding. The Board is of the view that the reorganisation of the assets in the merger circumstances contemplated does not effect a realisation of the owner's economic interest provided that interest continues in the merged business. It has similarities to the economic arguments in favour of the current scrip for scrip roll-over relief. Therefore, the tax liability should be deferred until the economic interests in the merged assets are disposed of or the taxpayer no longer has an active interest in the merged business – that is, a realisation of the taxpayer's economic interest.

1.14 *Asset merger combinations*

1.15 Asset mergers involve the direct combination of interests in assets between two or more entities to result in a jointly owned business or enterprise. The premise is that the combination of the businesses will improve economic outcomes, including efficiency and profitability. The parties, through the merger, combine their interests in the assets so that each has a proportion of the combined assets equal to their percentage contribution to the combined business. Although their interests have been combined, the parties to the transaction continue to be involved in the operation of the combined business and remain economically exposed to its success and profitability.

1.16 There are several approaches businesses can take in asset mergers and the Board does not propose to be too prescriptive about the form of asset merger transactions

² For example, mergers involving direct interests in assets are not within scope of the scrip for scrip roll-over relief.

³ For example, the scrip for scrip regime is an acknowledged departure from the principle of no change in economic ownership underpinning other roll-over provisions in the tax law.

provided certain criteria and integrity rules are satisfied to ensure the policy rationale behind the merger is met. The combination of assets can involve both horizontal asset mergers between assets that are similar (for example to achieve economies of scale) and assets that are different but complementary, for example mining/oil and gas production assets and related infrastructure.

1.17 *Asset for scrip mergers*

1.18 Asset for scrip mergers involve transactions where one or more merging participant transfers assets to a company in exchange for shares. The shares issued reflect the proportion of each participant's percentage contribution to the combined business. As with the asset merger combination, the participants maintain involvement in the operation of the combined business and remain economically exposed to its success and profitability. As the interests in the assets of the merged business are exchanged for scrip, they do not qualify for scrip for scrip roll-over relief, although the economic outcome is similar to that achieved through scrip for scrip merger.

OTHER CONSIDERATIONS

The deferral should apply to asset merger combinations and assets for scrip mergers by companies to the extent to which the taxpayer does not receive cash. A partial roll-over should be available where consideration other than an interest in the merged business is received, such as cash.

The Board has collated anecdotal evidence that a number of value-generating merger transactions in a range of key sectors may be viable if the proposed roll-over were available (See Appendix B for further details.) As such, the Board is of the view that this proposal will support the Government's plan to establish a strong national platform for jobs and growth.

1.19 In the Board's view a business merger/combination does not represent the crystallisation or realisation of a 'capital gain' or income and therefore is not a natural taxing point. This is because while the merged business continues to operate, the owners of the business (es) have not realised the value of the business asset/s in the manner envisaged by the tax system.

1.20 The proposed roll-over aims to defer the taxing point on value-generating merger transactions until an actual realisation event occurs such as the business owner cashing out of their interest in the merged business or otherwise divests of their interest in that merged business, or the business disposes of the rolled over asset/s. In this manner the roll-over is not a permanent deferral of the relevant gain but merely a deferral until the realisation of that gain occurs.

Such a deferral is consistent with the policy rationale underpinning scrip for scrip roll-over (Subdivision 124-M) and the mining tenement interest realignment roll-over (Subdivision 124-S) as well as the broader roll-over regime in relation to CGT and depreciating assets.

The roll-over relief should apply where “active” CGT and depreciating assets are contributed to an ongoing economic enterprise as part of a merger/business combination transaction. The recognition of the resulting capital gain and assessable income from balancing adjustments on disposal of depreciating assets should be deferred if:

- The original owner of the asset obtains an interest in the combined/merged business undertaking as consideration for the contribution of its interest; and
- The original owner of the asset continues to hold an ownership interest in the combined/merged business undertaking after the transaction.

1.21

Recommendation 1

The Board recommends that the Government introduce a principles-based roll-over which achieves a deferral of tax liability:

- on the disposal of ‘active’ CGT and depreciating assets which are contributed to an ongoing economic enterprise or to form an economic enterprise as part of a merger/business combination transaction; and
- until such time as the owner disposes of their interest in the merged business or the combined business disposes of the rolled over assets.

LIMITING THE SCOPE OF THE PROPOSED ROLL-OVER RELIEF

1.22 While the proposal could apply to a broad range of business structures and industries, the Board considers that the proposed roll-over relief should be targeted to cover asset mergers that are likely to provide the greatest economic benefit. The Board acknowledges that during the consultation process, a broad application of the proposal was considered attractive by consultees as it provided the greatest scope for deferral of tax on asset mergers. However, the Board must balance a range of considerations including the risks to revenue, the overall revenue cost of the measure and the integrity of the tax system. For example, there would seem to be little policy justification for roll-over relief if it resulted in a permanent deferral of income tax or inspired asset mergers of marginal economic benefit. Possible approaches to targeting of the measure could include:

- Limiting the roll-over to assets which are held by a company;
- Exclusion from the scope of the rollover certain industries or sectors that are covered by specific regimes or have unique characteristics that, prima facie, do not

fully accord with the objective behind the proposal (for example, the property sector and forestry managed investments schemes⁴);

- Applying a value threshold such that only transactions where the value of the merged business exceeds a certain level would be eligible for the roll over;
- Requiring ATO sign-off confirming the transaction meets the requirements of the roll-over. This will provide taxpayer certainty around the use of the proposed roll-over⁵.

Recommendation 2

The Board recommends that the roll-over be limited to assets held by companies only with a view to mitigating the cost to the revenue and in order to manage integrity concerns.

Recommendation 3

The Board also believes that requiring ATO confirmation that the transaction meets the requirements of the roll-over will enable the use of the roll-over to be monitored and to ensure the roll-over is being used in accordance with the policy intention of the measure. It would be expected that proponents of large transactions seeking access to the rollover would apply for ATO sign-off by way of a ruling as a means of obtaining certainty over the tax outcomes of the transaction and therefore this requirement is not considered to add significantly to the compliance cost of the measure.

While the proposed roll-over relief could apply to transactions of any size, as noted above further targeting could limit the application of the proposal to transactions which provide the greatest economic benefit. Higher value merger transactions are more likely to provide the large scale economic benefits that are the target of the proposal. Although not a Board recommendation, as well as a matter for judgement, consideration could be given to including a threshold so that only significant value transactions can access the roll-over. For example asset mergers with a transaction value of \$100 million or more could be considered an appropriate threshold for roll-over relief.

⁴ For example, in the property sector, assets are unlikely to be used in an ongoing, synergistic value-creating business enterprise following the combination in the manner envisaged by the Board. Further, the unique regime governing the taxation of investors in forestry managed investment schemes is directed at distinct policy initiatives that provide statutory deductions on revenue account and specific income inclusion rules that should not be altered by roll-over relief.

⁵ The request for a ruling would follow the ATO's normal ruling process regarding the application of the tax law to the circumstances of the taxpayer. It could also be included as part of an approved compliance program.

1.23 The Board's recommendations regarding the design of the integrity measures – discussed in Chapter 3 – will, in any event, appropriately exclude some sectors and businesses.

CURRENT TAX TREATMENT OF BUSINESS MERGERS

1.24 *General position*

At present, a business merger transaction at the asset or entity level is likely to result in a disposal of CGT assets and/or depreciating assets and would typically result in a tax liability on any gain on 'disposal' of these assets⁶. These types of transactions include:

- Formation of a new combined business (joint venture) via the contribution of assets by the participants (where the interest of each participant in the joint venture is commensurate with the market value of the assets contributed).
- Realignment of ownership interests in an existing joint venture arrangement (for example if a new participant joins the joint venture by contributing assets or an existing participant contributes additional assets).
- The formation of an unincorporated joint venture or a partnership via the contribution of assets in return for an interest in the joint venture or partnership (where the interest in the venture or partnership is commensurate with the market value of assets contributed).
- The formation of a company to house the merged business via the contribution of assets in return for shares in the company (where the value of the shares received is commensurate with the market value of assets contributed).
- The contribution of assets to merge with a business held in an existing company in exchange for shares in that company (where the value of the shares received is commensurate with the market value of the assets contributed).

Existing Roll-over relief

Roll-over relief to facilitate commercial transactions such as mergers, takeovers and realignments is currently limited to:

- Scrip for scrip roll-over in sub-division 124-M – which operates in very tightly constrained circumstances;

⁶ The resulting tax liability would be reduced or eliminated where, for example, the scrip for scrip roll-over applies in Subdivision 124-M.

- The mining tenement re-alignment provisions in section 40-363 and subdivision 124-S (which does not extend to assets other than tenements, and hence does not extend to infrastructure assets); and
- The partnership interest re-alignment provisions in subsection 40-340(3) and subsection 70-100(4) – this roll-over applies in respect of depreciating assets and trading stock only.

These roll-overs are generally based on the premise that deferring the up-front tax cost of such transactions (with such taxing point deferred until ultimate realisation) will facilitate value-generating activity.

GAPS IN THE CURRENT ROLL-OVER SYSTEM

Analysis of the current CGT and depreciating asset roll-over systems undertaken by the Board demonstrates that most current roll-overs either facilitate changes in legal structure only, or operate to alleviate tax consequences in cases where the taxpayer has suffered an inadvertent or unplanned loss (for example where an asset is compulsorily acquired, lost or destroyed).

Current roll-over relief is a patchwork with each roll-over introduced in isolation in order to address a specific and tightly constrained circumstance. Thus for some business reorganisations roll-over relief is available and not for others, even though both have similar economic outcomes. For example, roll-over relief is only available for business reorganisations involving scrip for scrip but not if the asset merger does not involve the exchange of shares for shares.

In some limited circumstances, where assets are held via a company, it is currently possible to facilitate a tax-deferred merger outcome using scrip for scrip roll-over. However, access to scrip for scrip roll-over may require the attempted utilisation of another roll-over beforehand to first restructure the business so as to be in a commercially sensible position to secure access to scrip for scrip roll-over, resulting in additional complexity and, in some cases, stamp duty issues.

In addition, the Board has received feedback during consultation that taxpayers and advisors consider transactions of this nature to entail high tax-risk and as such are usually dissuaded from undertaking the transaction in its entirety. This feedback accords with the ATO's concerns in relation to the scope for taxpayers to use back-to-back roll-overs in a manner that is inconsistent with the underlying policy intention of each roll-over when considered in isolation.

As a consequence, the current system allows the deferral of tax liability on only some commercially-motivated mergers, takeovers and realignments. There is no overarching principle-based roll-over available for merger transactions.

IMPACT OF CURRENT TAX TREATMENT

On the basis of the above and feedback during consultation and Working Group discussions, the Board is of view that the absence of more comprehensive roll-over relief is an impediment to value-generating business merger transactions. The up-front tax cost involved sets a high threshold that the benefits of each such transaction must satisfy in order to be viable. Current roll-overs that facilitate business mergers, takeovers and realignments operate with very limited scope.

In addition, the current tax treatments available to defer the tax payable on merger transactions (such as the use of “back-to-back” roll-overs) are perceived to be high tax-risk and frequently act to dissuade merger transactions.

INTERNATIONAL COMPARISONS

1.26 In considering its recommendation the Board has looked at the treatment of roll-overs in other countries. While there are no roll-overs exactly comparable to the roll-over proposed in this paper, many OECD countries provide for roll-over relief from CGT in the case of business and corporate restructures. For example, the approach in the United States of America, Canada and the United Kingdom, relief may be available where like assets are swapped, where assets are replaced, or where assets are transferred to a new company, although the scope of the relief varies from country to country. Similarly a report commissioned in 2006: *International Comparison of Australia's taxes*⁷ indicated that roll-over relief was available in a number of OECD countries for asset replacement or like for like exchanges.

OTHER MATTERS

Stamp duty

In a business reorganisation the change in ownership of assets can trigger state and territory stamp duty liability. For example, stamp duty may be payable on the acquisition of shares in a company or units in a unit trust scheme that has land holdings, or of business assets or of land. In some states, exemptions are provided for dealings in assets between members of a corporate group. But the extent of these exemptions are limited and do not apply to cover all of the scenarios envisaged by the Board's roll-over relief proposal.

There may be some transactions which may still not be viable should an income tax roll-over be implemented in absence of a stamp duty roll-over mechanism where the quantum of stamp duty involved is significant. However, the Board has received strong anecdotal feedback via consultation that income tax relief is a worthwhile proposition in light of the intended policy objectives, even in the absence of stamp duty relief for transactions within the scope of the proposed roll-over relief. This is on the

⁷ International Comparison of Australia's Taxes 3 April 2006. See Appendix table 6.2.1.

basis that in some circumstances removal of the income tax cost or risk alone can restore the viability of the transaction.

During consultation it was also highlighted that extending the roll-over to transactions involving mergers at a share level would not only enable better commercial flexibility but would also enable more transactions to fit within existing stamp duty relief mechanisms. However, achievement of the policy objective to remove impediments to business combinations will be most effective if stamp duty relief is also available.

While the issue has been raised with the Board, this is not a matter that is appropriate for the Board to take forward with State and Territory governments directly. However, the Board received strong feedback during consultation that it would be optimal if the Government would consider raising the possibility with the States and Territories of introducing a complementary roll-over mechanism for similar transactions. There is precedent for states allowing stamp duty relief based on income tax relief. In this regard, see especially section 250DI of the Duties Act 2000 (Vic), sections 122 and 193A of the Duties Act 2001 (Qld), paragraph 56M(2)(c) of the Duties Act 1978 (NT), section 115J of the Duties Act 1999 (ACT) and Revenue South Australia Information Circular No. 35 regarding the Stamp Duties Act 1923 (SA) in relation to the roll-over relief available under Subdivision 124-Q of the ITAA 1997. Also see subsection 66(9) and section 99 of the Duties Act 1997 (NSW) in relation to the roll-over relief available under Subdivision 124-M and Subdivision 122 of the ITAA 1997 respectively.

An additional option would be the deferral of the payment of stamp duty (for example by allowing stamp duty to be paid in instalments over time when the economic activity facilitated by the roll-over is realised), rather than permanently deferred. Such a policy would at least somewhat alleviate impediments to business combination transactions while limiting the impact on State and Territory finances.

Recommendation 4

The Government considers raising with the States and Territories complementary stamp duty roll-over relief for similar transactions.

Rationalisation of existing roll-overs

1.27 In considering the issues canvassed in this paper, the Board noted the degree of complexity associated with the existing roll-over exemptions and the likely costs associated with taxpayer compliance. This includes the recognition that, if accepted, the Board's proposal while addressing some of the current impediments to asset mergers will be creating an additional roll-over provision. It follows that certainty would be enhanced and complexity reduced if the existing roll-overs were replaced by a principle based provision covering all circumstances. However, this is a significant task and one that is outside the scope of the Board's current work. .

1.28 Therefore, the Board considers that it may be worthwhile to consider reviewing the existing system of roll-overs so that they are not repetitive and can address a number of similar transactions. This position was supported by both consultees and the ATO. This would deliver simplicity and administration benefits in comparison to the current system of incremental, issue-specific roll-overs. The current roll-overs place a heavy burden on taxpayers and the ATO in addressing transactions that are economically similar but where it is arguable whether they fit within the scope of the existing roll-over relief.

1.29

Recommendation 5

The Board recommends as a longer-term initiative, the existing system of roll-overs be revised through replacing the relevant provisions with a smaller number of principles-based roll-overs which clearly articulate the underpinning policy rationale.

CONCLUSION

1.30 Roll-over relief for asset mergers and asset for scrip mergers is intended to be a policy enhancement to the existing roll-over relief arrangements. It is similar to the concept of the combination of businesses which occur by way of swapping shares in one company for shares in a new company in the event of a merger or takeover. Whilst some industries are more likely to benefit from the roll-over (for example, energy and resources industry), feedback via consultation suggests that there is potentially a range of industries which could benefit.

1.31 Nonetheless, the Board is cognisant of the argument that roll-over relief proposal could be used in ways that do not deliver maximum economic benefits or misused to avoid income tax. There will also be concerns about the impact on government revenue and the integrity of the tax system. For this reason the Board has indicated that the scope of its proposal should be narrowed to only cover assets held by companies and potentially further targeted to exclude sectors that have unique characteristics that, prima facie, do not fully accord with the objective behind the proposal. A requirement for the taxpayer to obtain ATO sign-off will provide an additional level of integrity and certainty for taxpayers. Consideration could also be given to a transaction value threshold.

1.32

CHAPTER 3: DESIGN OF THE INTEGRITY MEASURES

ADDRESSING INTEGRITY ISSUES

Appropriate integrity principles should be put in place to ensure that the roll-over applies only as intended and does not permit activity beyond the scope of the policy intent of the roll-over or that otherwise undermines the integrity of the tax system.

Principles-based law (discussed further below) should be introduced to ensure the extension of roll-over relief to the merging of assets, including into jointly owned companies, does not result in a roll-over for what is effectively an exiting from the business. Consideration should be given to a guiding principle such as ‘genuine business merger’ to clarify the intended scope of application of this roll-over, with implementation details and examples included in accompanying early ATO advice where possible and appropriate. Such a principle should ensure that roll-over relief is not available in relation to:

- a final disposal/realisation of assets (that is, cashed-out and/or reinvested in new assets unrelated to the merged business activities);
- divestment or wind-up of a business;
- the rolling of business assets outside the Australian tax net (for example, where the purchaser would not be subject to tax in Australia on a subsequent sale of those assets); or
- an “asset-swap” that is the exchange for a ‘like-kind’ asset unrelated to the merging of activities.

1.33 The Board is mindful that the introduction of roll-over relief for asset merger combinations or asset for scrip mergers should not create an opportunity for the indefinite deferral or avoidance of a tax liability. The Board considers there are two broad integrity themes in this regard: The eligibility to access the roll-over relief; and adjustments to the tax values following the asset merger combination or asset for scrip merger.

Eligibility Issues

The Board has considered a number of specific eligibility issues that may arise in respect of asset merger combinations and asset for scrip mergers. These arise because the deferral of taxation for the merging of assets or the exchange of assets for scrip, will give rise to how these assets are taxed in the future. The proposed roll-over relief provides for deferral, not elimination of taxation. Therefore, the outcome of a merger should not result in a more generous treatment of the cost base, losses or the taxation of non-residents compared to if taxation had applied to the unmerged assets.

Further, merger transactions are also likely to involve a “true-up” cash payment as owners will usually use the transaction as an impetus to re-align their ownership interests. On this basis, roll-over relief should be limited to the extent to which the transaction is cash-less. Pro-rata relief should be available where the transaction involves some cash (or indeed other hybrid instruments that provide economically equivalent outcomes to cash) or other non-eligible consideration.

1.34 To aid consideration of this roll-over relief proposal, the Board proposes that the following approaches be further explored. Based on discussions with the ATO and the Working Group, it is the Board’s view that all of the integrity issues identified are able to be resolved. However, there are some integrity risks where further consideration should be given as to whether such risks warrant the associated additional complexity required to address them.

Interest requirements

Each participant to an asset merger should be required to hold a percentage interest in the totality of the combined active assets and their overall interest in the combined business should be proportional to the relative value of the assets each participant contributes. Likewise, in asset for scrip mergers, the number of shares received by each participant to the merger should be proportional to the relative value of the assets the participant transferred to the company. Conceptually, a similar principle should apply when assets are merged into an existing company⁸.

Recommendation 6

A minimum 20 per cent holding rule could be included with a principle-based fall back provision to ensure that failure to hold the minimum percentage is not fatal to accessing the roll-over relief, subject to the participants demonstrating an active involvement in the combined business.

Factors to consider in demonstrating the requisite level of active involvement under such a principle could include various indicators, such as board participation, management involvement, shareholder agreements, participation in expenditure and other committees relevant to the operation of the business, continued exposure to risk and any ongoing commitment to provide further capital to the merged business.

A requirement to demonstrate active involvement in the management of the business in all cases is not favoured as it would be highly subjective in application, subject to disputes between the ATO and taxpayers and not constitute a natural taxing point. Further, in some industries, the owners of the business do not routinely participate in the management of the combined enterprise. For example, joint ventures in the oil and gas and mining industries typically involve many joint owners but only one ‘operator’.

⁸ Where the application of asset for scrip roll-over relief involves an existing company, further integrity rules may need to be considered in circumstances where the existing company has a substantial portion of non-eligible retained assets - for example, a substantial cash balance.

Joint owners do however remain economically exposed to the outcomes of the enterprise, have ongoing commitments to fund capital expenditure and may participate in joint venture management and other committees.

Consideration should also be given to a safe harbour 'bright-line' test based on a minimum period for which participants must continue to hold their interests in the combined business subsequent to the roll-over.

Preventing the trading of unrealised losses

Maintaining tax system integrity around the transfer of unrealised losses in the context of a direct asset merger scenario is not considered to be an issue because it is proposed each participant retains their tax cost related to the portion of assets they transfer (this is further discussed below under 'Cost adjustment issues'). Accordingly, the participants are unable to transfer unrealised losses.

Recommendation 7

The Board recommends that further deliberation be given to preventing the trading of unrealised losses in an asset for scrip merger scenario. One approach to be explored is to stipulate that of the assets transferred by the participants to a company under the merger, overall there must be no net unrealised loss.

In relation to unrealised losses more generally, the proposed roll-over relief should not provide the opportunity to accelerate crystallisation of unrealised losses while deferring unrealised gains in relation to a package of assets transferred as part of a merger. To address this, it is proposed that where roll-over is elected, it must apply to all assets transferred.

Preventing the erosion of TARP status

The Board has some concerns that the proposed roll-over provision should not facilitate non-residents avoiding their CGT obligations for their interest in Taxable Australian Real Property (TARP). In the context of the direct asset merger, a non-resident transferring a portion of a TARP asset should not receive a portion of a non-TARP asset in exchange. The Board has identified three possible options to address this issue that should be considered further:

1. The roll-over relief provisions could regard the portion of the non-TARP asset received by the non-resident as ineligible proceeds. The non-resident would still be entitled to pro-rata relief on the portion of any TARP assets it receives in exchange.
2. The non-resident is denied access to the roll-over altogether.
3. The non-TARP assets received by the non-resident could be deemed for all subsequent purposes as TARP assets.

Furthermore, in the context of asset for scrip mergers, the Board has identified a concern whereby at first, the shares received by the non-resident in consideration for the transfer of assets are TARP assets (because the share-holding is greater than the 10% non-portfolio holding requirements and also due to the nature of the underlying assets of the company at that time) but at some future point in time, the shares cease to be TARP assets.

Recommendation 8

It is recommended that consideration be given to deeming, where appropriate, shares received by the non-resident in consideration for the transfer of TARP assets, to always be TARP assets.

Cost base adjustment and asset status rules

1.35 Precedents in other areas of the current tax law may provide a path that could be adopted in seeking to address integrity issues associated with cost adjustment issues and asset status issues.

1.36 *Asset Merger*

1.37 First, in the case of an asset merger, there is sense in adopting the cost allocation approach taken in the interest realignment provisions of 124-S. That is, each participant's cost should remain unchanged, but the cost base or adjustable value of the participant's original portion of assets disposed of under the roll-over be transferred to the cost of the portion of assets received in exchange.

1.38 Second, the Board is aware that integrity concerns could arise under this approach in that an unrealised revenue gain embedded in the portion of assets transferred may convert to an unrealised capital gain in respect of capital assets received in exchange. This may provide inappropriate benefits to the transferor, who may have capital losses available to offset capital gains. Excluding trading stock (which is a major revenue asset) from roll-over relief will alleviate this concern to some extent. Furthermore, to the extent that a gain is realised on the acquired assets on subsequent disposal, decision-makers should consider whether these risks warrant rules to tag the proportional amount of the swapped assets received as having revenue status.

1.39 Conversely, there may be a disadvantage to a participant in situations where an unrealised capital gain embedded in the portion of a capital asset transferred may be allocated to a portion of a depreciating asset received in exchange. A disadvantage arises to the extent that the participant would otherwise have been able to offset capital losses but for the roll-over. However, subject to further review, this issue may not be required to be specifically addressed as the participant could decide not to choose roll-over relief and offset the losses instead.

1.40 Third, where a portion of a capital asset is transferred in exchange for a portion of a depreciating asset, further consideration should be given to the advantageous tax outcome related to CGT cost base becoming depreciable.

1.41

Recommendation 9

The Board recommends following the cost allocation approach taken in the interest realignment provisions of 124-S.

Unrealised revenue gain embedded in the portion of assets transferred may convert to an unrealised capital gain in respect of capital assets received in exchange. To address this trading stock should be excluded from roll-over relief and to the extent that a gain is realised on the acquired assets on subsequent disposal, consideration be given to tagging the proportional amount of the swapped assets as receiving revenue status.

Consideration be given to explicitly addressing advantageous and disadvantageous tax outcomes related to the CGT cost base where a capital asset is exchanged for a portion of a depreciating asset.

1.42 *Asset for scrip merger*

1.43 There are three further issues to consider in relation to cost adjustments rules in the context of the asset for scrip merger.

1.44 First, the shares received by each participant in exchange should have a cost base equal to the cost base of the merging assets each participant transfers to the company. The company should also inherit the cost bases of capital assets transferred to it and adjustable values of depreciating assets transferred to it. This mirrors the approach currently taken in the tax law for the *significant stakeholder* and *common stakeholder* provisions in the scrip-for-scrip regime.

1.45 Second, in limited circumstances, it may be that a depreciating asset in the hands of the transferor changes status in the hands of the company and is held on capital account. Conversely, in some cases it may be that a capital asset in the hands of the transferor may become a revenue asset to the company recipient⁹. Further consideration will need to be given to this issue.

1.46 Third, prima facie, the transferor may receive a capital asset (that is, shares) in exchange for assets held on revenue account that are transferred to the company. This may be somewhat alleviated to the extent that any unrealised revenue gain embedded in transferred depreciating assets would also be transferred to the company.

1.47 While it is yet to be determined as to whether the integrity risk justifies the associated complexity of dealing appropriately with this issue, further consideration should be given to a similar rule to that noted above, whereby a proportional amount

⁹ This is possibly the case in relation to the transfer of pre-2001 mining rights.

of the shares received by the transferors be permanently tagged as having a revenue status.

1.48

Recommendation 10

The shares received by each participant in exchange should have a cost base equal to the cost base of the merging assets each participant transfers to the company. The company should also inherit the cost bases of capital assets transferred to it and adjustable values of depreciating assets transferred to it.

Further consideration be given to the treatment of capital assets and revenue assets that change status in the hands of the company recipient.

Consideration be given to the situation where a transferor may receive a capital asset (that is, shares) in exchange for assets held on revenue account that are transferred to the company, including whether a proportional amount of the shares received by the transferors are permanently tagged as having a revenue status.

1.49 Consolidations Interaction

1.50 By way of general comment, careful consideration should be given to the interaction with the Consolidations regime to ensure tax values of contributed assets in an asset for scrip merger involving a Head Company of a Consolidated Group do not receive a step-up through the 'Allocable Cost Amount' tax cost setting process. This is not thought to be a concern in a straightforward application of the asset for scrip merger, but it is recognised as a potential risk if there is subsequent scrip for scrip transactions that also invoke roll-over relief.

1.51 For convenience, Appendix C articulates the issues addressed above in table format.

COSTS / RISKS / BENEFITS

To the extent that the proposed roll-over would require a change to the *status quo*, the Board is of the view that the costs and risks involved would be outweighed by the benefits of the proposal.

This is because:

- The economic and other benefits of value-generating merger activity that would result as a consequence of introducing the proposed roll-over would outweigh the costs.
- The key risks involved can be addressed through appropriate mitigation strategies and integrity measures.

Costs

Revenue cost

The proposal will have a revenue cost to the extent that roll-over relief allows the deferral of tax on transactions that would nevertheless have taken place. The revenue cost will be equal to the tax that would have been payable on those transactions. It can be argued that a deferral of tax liability will provide a proponent with a cash flow benefit, while the Commonwealth takes on the risk of non-payment of the deferred tax should the asset merger not deliver the expected benefits. While the Board does not intend that its proposal increase the risk to Commonwealth revenue, the Board understands that Treasury is preparing a brief which includes further consideration of the likely revenue cost of the proposal.

Anecdotal feedback received by the Board suggests that the revenue cost of the proposal should be limited as merger transactions of this nature do not currently progress if the relevant CGT liability or tax on gain on sale of depreciating assets is substantial. The potential longer term benefits of a merger transaction would be overshadowed by an up-front cash payment of tax, especially where there is no cash coming home to the taxpayer at the time of the transaction. Where merger transactions nonetheless proceed, the parties involved seek to minimise the tax cost involved using complex contractual arrangements or via highly structured outcomes which seek access to existing roll-overs and taking on more tax risk. As such, the tax paid on such transactions is minimal.

Complexity

1.52 Creating additional exemptions in the CGT net and in other parts of the tax acts may lead to additional tax complexity and may be perceived to be a further ‘hollowing’ of the corporate tax base.

Risks

Integrity risks

There may be an adverse impact on the integrity of the tax system if the proposed roll-over could be utilised in a way that is inconsistent with the policy intent.

As discussed above, the Board has identified some potential integrity concerns through the Working Group process and via consultation. However, in the Board’s view, these risks are not fatal to the proposal and can and should be addressed through a prudent law design process and vigilant administration. As discussed in Chapter 2, the Board has recognised these concerns and recommended that the scope of its proposal be confined, for instance, to companies.

Benefits

Increase in economic activity

While the proponents under this proposal will receive an upfront benefit of a deferral of tax for assets merged, the proposal is expected to generate an increase in economic activity through value-generating merger activity and business combination transactions that would otherwise not take place. See Appendix B for examples of the types of transactions that may be viable if the proposed roll-over is introduced (on the basis of anecdotal feedback collected during consultation).

Reduced complexity and greater certainty

1.53 The proposal should result in reduced tax, legal, commercial and accounting complexity and compliance costs for taxpayers who are currently contemplating or progressing merger transactions attempting to use complicated tax structuring techniques. Whilst there may be some tax related complexity in establishing cost bases on implementation of the roll-over, the roll-over would facilitate transaction structures better suited to the commercial imperatives as compared with structured outcomes which embed enduring commercial and legal complexity.

1.54 The proposal should result in greater certainty for taxpayers in relation to taxation outcomes which may be unclear or contested under current law where complex structuring is utilised to access viable outcomes (for example, the capacity to use back-to-back roll-overs). In the longer term, further rationalisation and simplification of the current system of roll-overs will also yield simplification benefits.

Greater flexibility

The proposal should create further flexibility for businesses seeking to grow or expand their operations in innovative ways through removal of tax barriers to commercially viable transactions.

IMPLEMENTATION CONSIDERATIONS

Date of commencement

A prospective application date would be appropriate in light of the policy intention to facilitate value-generating merger activity in the future.

Recommendation 11

The Board recommends that application of the roll-over be prospective in application, for example from date of Royal Assent.

Interactions with existing Australian tax laws

The Board is of the view that interactions with the income tax consolidation regime should be carefully considered to ensure that taxpayers that have formed a tax consolidated group are not discouraged from utilising the roll-over due to adverse consequences caused as a result of unintended interactions. Conversely, the roll-over should be designed to defer taxation on the gain that represents an increase in value of the assets only. For example, an L5 capital gain that results from a deconsolidation that occurs as part of a merger transaction should not be subject to the roll-over as it does not represent the taxation of the increase in value of the asset/s involved.

Interactions with other roll-overs should be carefully considered during any legislative design phase, especially scrip-for-scrip roll-over in Subdivision 124-M. In particular: Consideration should be given to the benefits available under the scrip for scrip roll-over to ensure that the proposed roll-over does not inadvertently extend the scope of that roll-over beyond its intended scope.

Law design considerations

Principles-based drafting

The proposed roll-over should be drafted in the principles-based technique, with implementation details, guidance and examples included in ATO guidance as appropriate. This is because principles-based drafting allows the law to be sufficiently flexible to address unforeseen circumstances. It is further recommended that the ATO issue accompanying practical guidance (such as 'Law Companion Guidelines') on the limits and integrity concerns underpinning the principles in the law to assist taxpayers to self-assess access to the roll-over.

Recommendation 12

The proposed roll-over should be drafted in the principles-based technique, with implementation details, guidance and examples included in ATO guidance as appropriate.

Recommendation 13

The ATO issue accompanying practical guidance (such as 'Law Companion Guidelines') on the limits and integrity concerns underpinning the principles in the law to assist taxpayers to self-assess access to the roll-over.

1.55 The Board has received positive feedback from the ATO as well as Chartered Accountants Australia and New Zealand in relation to certain aspects of the drafting style of the recently introduced ‘small business restructure roll-over’ in subdivision 328-G. In that subdivision, the law seeks to define the arrangements to which the roll-over is intended to apply. That is, “genuine business restructures”, while implementation details and examples have been set out in greater detail in the ATO’s Law Companion Guidelines 2016/2 and 2016/3.

1.56 Similarly, the Board suggests that consideration be given to a principle, such as ‘genuine business merger’, be defined in the law to clarify the intended scope of application of this roll-over, with implementation details and examples included in accompanying early ATO guidance where possible and appropriate.

As noted in Chapter 2 the Board is of the view that taxpayer certainty will be aided if access to roll-over relief is only available where the participant has received a ruling from the ATO that use of the roll-over is appropriate. Taxpayers should also be required to indicate in their tax returns when they have elected roll-over to enable the ATO to effectively monitor the use of the roll-over and effectively scrutinise transactions to ensure outcomes are consistent with the policy intent.

Recommendation 14

Consideration be given to a principle, such as ‘genuine business merger’, be defined in the law to clarify the intended scope of application of this roll-over, with implementation details and examples included in accompanying early ATO guidance where possible and appropriate.

APPENDIX A: SUMMARY OF CONSULTATION FEEDBACK

Organisation	Summary of Views
<p>Australian Petroleum Production and Exploration Association (APPEA)</p> <p>Specifically:</p> <p>Noel Mullen (APPEA)</p> <p>Tony Principe (Origin Energy)</p> <p>Michael Fenner (Chevron)</p> <p>John Condon (BP)</p>	<p>The proposed roll-over relief proposal is likely to be utilised in the Oil & Gas sector.</p> <p>Tax cost poses a significant impediment to merger transactions, especially when the market price for oil is at long term lows.</p> <p>In particular, the proposed relief would facilitate:</p> <ul style="list-style-type: none"> • Realignment of interests in existing unincorporated Joint Venture (JV) structures to drive alignment of project objectives (note existing tenement realignment measures do not provide relief in respect of processing or downstream assets); • Entering into new arrangements regarding the joint ownership of upstream or downstream plants and facilities used in developments; and • Sharing facilities and infrastructure. <p>Comments in relation to specific features of the proposed roll-over:</p> <ul style="list-style-type: none"> • The history of oil & gas operations in Australia demonstrate that quite frequently facilities could be shared or asset mergers could be worthwhile, but usually do not progress as a realignment of interests in the project is not tax effective or entails too much tax risk. Contractual arrangements can yield similar outcomes but contractual rights are usually insufficiently secure over the time frame of the project i.e. 10-20 years. • Any proposed roll-over relief should be extended to include transfer of ancillary contractual agreements. • It is reasonable to limit access to the roll-over for “like for like” assets i.e. cannot merge interest in oil and gas project with an interest in an apartment block in Sydney. • Requirement to maintain “active participation” in the merged business should be satisfied by continued share / interest holding to prevent disputes about what “active participation” entails, especially where only one JV participant or a third party is the project operator. • Strong boundaries/safe-harbours/integrity rules should be used in order to provide certainty to entities that the ATO won’t unwind transactions based on their reading of subjective factors. • Relief from State stamp duties would be welcome as stamp duty is also an impediment to merger transactions. However, income tax relief alone would nevertheless drive the underlying policy objective and be worthwhile. • Some support for relief for ‘swap’ transactions in order to facilitate swapping of lease / license agreements in relation to specific projects, and/or ‘swapping’ of access to supporting infrastructure for an interest in the project.

Organisation	Summary of Views
	Specific examples provided by APPEA members have been included at Appendix B.
<p>Australian Private Equity & Venture Capital Association Limited (AVCAL)</p> <p>Specifically:</p> <p>Christian Gergis (AVCAL)</p> <p>Ryan Davis (EY)</p> <p>Dragan Mistic (EY)</p> <p>Toby Eggleston (G&HSF)</p>	<p>AVCAL members noted that an asset roll-over relief is unlikely to have substantial use in the private equity / venture capital industry as most investments are undertaken via a company structure. Mergers between “Target Co” and another entity in the same industry are relatively uncommon due to the nature of the industry.</p> <p>A roll-over of this nature may assist smaller Australian companies to achieve economies of scale and compete in a global market place.</p> <p>Comments in relation to specific features of the proposed roll-over:</p> <ul style="list-style-type: none"> • The Board should consider whether roll-over relief will include “rolling over” of the original acquisition date, character of the interest etc. • The Board should seriously consider expanding the roll-over proposal to include the contribution of assets in return for the issue of shares and/or mergers entirely at the share-holding level if the roll-over is to be used to drive business mergers in a way that is agnostic in relation to entity structure. • The Board should consider recommending the expansion of scrip for scrip roll-over to remove some of the key impediments to transactions, especially the ‘substantial interest’ requirement and the requirement to make an offer to all shareholders on substantially the same terms (as this leaves the buyer at risk of achieving a commercially viable result). • It would also be worthwhile to consider relief from state taxes. <p>The immediate result from an expansion of scrip for scrip roll-over may not be additional economic activity. The more likely short term effect would be a lowering of the overall tax cost and risk, leading to increased funds and greater efficiencies in the market.</p>
<p>Boyce & Co Chartered Accountants – commissioned by the Rural Industries Research and Development Corporation to undertake research on Taxation in the Agriculture Industry</p> <p>Specifically:</p>	<p>The agriculture industry is comprised approximately:</p> <p>10-15% “corporate operators”</p> <p>10-15% large family businesses</p> <p>70% smaller businesses that qualify for small business CGT concessions. (by value and numbers).</p> <p>The proposal is likely to only be useful for the first two categories above.</p> <p>However, mergers in this industry are rare. Tax does not seem to play a large part in this – the major factors at play are that:</p> <ul style="list-style-type: none"> • Most operators prefer to acquire land and run their own business on acquired land rather than jointly operate businesses with other operators. • This is because a business typically does not have much goodwill attached as the product is generic in nature. Differentiated products

Organisation	Summary of Views
Jonathan Forrest (Boyce & Co)	<p>are usually sold through co-operative structures rather than via mergers.</p> <ul style="list-style-type: none"> Land can be utilised in many ways other than via a business merger e.g. share farming, stock adjustment etc. <p>Most transactions usually relate to succession planning or divestment rather than mergers.</p> <p>Grain Growers may benefit from the proposal as this sub-industry is characterised by broad-acre cropping and larger scale.</p>
<p>Business Council of Australia (BCA)</p> <p>Specifically:</p> <p>Tony Stolarek (EY)</p> <p>Vicky Coulson (Woodside)</p> <p>Marcus Hughes (Fortescue)</p> <p>Further input provided by members in the airline and steel manufacturing industry</p>	<p>The proposed roll-over is likely to facilitate merger activity in a range of industries, including (but not limited to) oil & gas and mining.</p> <p>Specific comments on the proposed roll-over:</p> <ul style="list-style-type: none"> The original business owner should be required to hold an ownership interest in (rather than actively participate in) the merged business, in order to not artificially restrict the roll-over to exclude business owners that contribute assets other than management involvement e.g. technology. The proposed roll-over should apply equally to share transactions in order to implement the underlying principle irrespective of legal form. Most businesses prefer to structure via a company to meet regulatory requirements e.g. in relation to employee contracts, Government contracts and approvals etc. Taxpayers in the large business sector are likely to be indifferent to any requirement to notify the ATO of the intention to use the roll-over due to the early engagement model that the ATO is already using in this sector. The proposed roll-over should be drafted with bright line tests that allow most taxpayers to self-assess applicability with only complex cases requiring specific ATO guidance. The Board should consider whether the roll-over should also apply to revenue assets and trading stock – what is the policy rationale for excluding these assets? It is possible to effect quasi-merger outcomes via back-to-back roll-overs, but this is generally considered to be a high tax-risk alternative. The interactions with income tax consolidation need to be carefully considered. A key consideration in merger transactions will be capital gains on deconsolidation. A key blocked to merger transactions is the inability to successfully transfer losses in a merger event. This is especially relevant where struggling businesses with realised or unrealised losses seek to merge. <p>Specific examples provided by BCA members are included at Appendix B.</p>
Chartered Accountants Australia and	<p>Specific comments on the proposed roll-over:</p> <ul style="list-style-type: none"> Consideration should be given to revising or expanding existing roll-

Organisation	Summary of Views
<p>New Zealand (CAANZ)</p> <p>Specifically:</p> <p>Matt Hayes</p> <p>Susan Cantamessa</p>	<p>overs rather than introducing a new, potentially overlapping roll-over.</p> <ul style="list-style-type: none"> Any GST interaction and income tax consolidation issues should be carefully considered. Consideration should be given to what tax attributes will be transferred as part of the roll-over e.g. cost base, acquisition date, franking credits etc. Consideration should be given to bringing share transactions within scope as many businesses are structured via a corporate. Otherwise, there is a risk that the roll-over will only apply in the energy and resources space. There may be parallels in the new small business restructure roll-over (in subdivision 328-G) that could be leveraged e.g. requirements that the transaction be a 'genuine business restructure'. The capacity to use the roll-over to convert revenue gains and losses into capital gains and losses (and vice versa) should be carefully considered and addressed. The proposed roll-over should not inadvertently expand the availability of roll-overs in a manner that is in contravention of boundaries drawn around the scope of existing roll-overs. The Board should consider the role that tax played in recent high-profile mergers. The Board should consider whether assets and liabilities should need to be transferred concurrently as part of a merger transaction. <p>In relation to businesses involving intellectual property, the primary asset being contributed may be either services or future work product. As such, the proposed roll-over may be 'old-fashioned' in focussing on CGT and depreciating assets.</p> <p>The proposed roll-over could apply to mergers of professional partnerships.</p>
<p>Corporate Tax Association (CTA)</p> <p>Specifically:</p> <p>Paul Suppree (CTA)</p>	<p>The CTA are broadly in favour of the proposed roll-over relief.</p> <p>The CTA noted that the fact roll-over relief exists for certain types of transactions (such as scrip for scrip), but not for other transactions which are economically equivalent distorts business decisions and may lead to sub-optimal outcomes, or tax planning to achieve a result that should have been there in the first place. The proposed asset roll-over merger relief may go some way towards removing this distortion.</p> <p>The CTA provided the following examples of the types of transactions the proposed relief may facilitate:</p> <ul style="list-style-type: none"> unincorporated businesses merging (e.g. a couple of tradies wanting to set up a "building partnership"); someone contributing assets to an existing company/trust in exchange for share or units in a unit trust, but who maintains an active participation in the larger enterprise and do not meet the

Organisation	Summary of Views
	<p>small business roll-over tests;</p> <ul style="list-style-type: none"> • a partnership merging with another partnership where assets are pooled; • someone contributing an intellectual property to a large organisation and receiving shares in return; and/or • large entities contributing assets to a new entity in exchange for shares (may be in the mining sector in particular). <p>However, initial response indicated that the roll-over would likely not facilitate mergers between listed companies, and that the applicability of the roll-over would likely be limited to the oil & gas and mining sectors unless mergers of incorporated entities were brought within the scope of the roll-over.</p> <p>Comments in relation to specific features of the proposed roll-over:</p> <ul style="list-style-type: none"> • The CTA queried any requirement for business owners to ‘actively participate’ in the merged business – what would this mean in practice? • The CTA noted that the roll-over should not be restricted to mergers in the same industry to avoid picking winners. • The Board should consider whether an active asset merger outcome (deferral of balancing adjustments) can be achieved by the contribution of the use of assets to an unincorporated joint venture, whereby joint venturers contribute the use of existing assets to a “notional pool” of assets and jointly use those assets; • The Board should consider whether qualification for the proposed asset merger roll-over should be subject to a business turnover test or maximum net asset value test; • The CTA queried if the proposed relief is not intended to apply for disposals of assets outside the Australian tax net, would the roll-over apply to disposals from one CFC to another. • The Board should consider whether mergers of companies should be brought within scope. <p>Specific examples provided by CTA members have been included at Appendix B.</p>
<p>Minerals Council of Australia (MCA)</p> <p>Specifically:</p> <p>James Sorahan (MCA)</p> <p>Premila Roe (BHP Billiton)</p> <p>Dominic Smith</p>	<p>The MCA is in favour of the proposed roll-over relief as it removes artificial tax barriers to commercially viable transactions.</p> <p>The MCA noted that the proposed relief would facilitate synergistic combinations of mining assets to allow a JV project to progress (i.e. one entity owns tenements, another entity owns facilities, combine the two to facilitate commercial project.)</p> <p>Comments in relation to specific features of the proposed roll-over:</p> <ul style="list-style-type: none"> • The Board should consider whether inventory and trading stock should be included as assets that qualify for roll-over relief; • The Board should consider whether the roll-over should also apply

Organisation	Summary of Views
(Glencore)	<p>at the shareholding level (if a business is incorporated);</p> <ul style="list-style-type: none"> The Board should consider whether any requirement to ‘actively participate’ in the merged business requires involvement in management or an interest holding in the business only – the latter is preferable in the mining industry as the operator may only be one of the interest holders or a third party altogether; The MCA noted that the roll-over should apply to “shares” rolled over as one of the assets of the business (given difficulties involved in merging employee contracts, assigning and registering mining rights etc.); The treatment of losses attached to merged assets, specifically whether losses should also be rolled over. <p>Consultees noted some overlaps that would need to be negotiated between the proposed roll-over relief, scrip for scrip relief and the new mining interest realignment relief (which has been useful, but is considered to be restrictive in application).</p> <p>Specific examples provided by MCA members have been included at Appendix B.</p>
<p>National Farmers Federation (NFF)</p> <p>Specifically:</p> <p>Scott Kompo-Harms (NFF)</p>	<p>The NFF is broadly in favour of the proposed roll-over relief.</p> <p>Some members of the NFF’s Competitiveness Committee had indicated that the proposal would be useful, especially as land values in agricultural businesses tend to be a significant percentage of total asset holdings (by value).</p> <p>The Grain Growers sector had shown greatest interest, likely because there is greater scope to achieve economies of scale in this industry (as compared to other agricultural outputs). The agriculture industry has seen a lot of takeover activity and consolidation in the past decade.</p> <p>The NFF also noted that the Rural Industry Research and Development Corporation have commissioned research into <i>Taxation in Agriculture</i> being conducted by Accounting Firm Boyce & Co. See above for summary of discussions with Boyce & Co.</p>
<p>The Tax Institute (TTI)</p> <p>Specifically:</p> <p>Stephanie Caredes (The Tax Institute)</p> <p>Tim Neilsen (G&HSF)</p> <p>Stuart Glasgow (Mutual Trust))</p>	<p>The applicability of this roll-over would be limited at the ‘top end of town’ unless share transactions were brought within scope.</p> <p>However, the proposed roll-over is likely to have applicability in a range of situations in the small to medium business sector, especially for entities that do not meet the small business CGT thresholds, either by facilitating mergers or by reducing tax risk on mergers that are going ahead anyway by using high-risk tax strategies e.g. back-to-back roll-overs.</p> <p>Many of the businesses that would benefit cannot benefit from a scrip for scrip roll-over as they are structured as unit trusts, discretionary trusts or sole traders.</p> <p>Cash cost is currently an impediment to such transactions as if the merger does not result in cash being ‘taken off the table’, the resulting tax liability needs to be funded from working capital.</p>

Organisation	Summary of Views
	<p>Specific comments on the proposed roll-over:</p> <ul style="list-style-type: none"> • Pro-rata relief should be available for transactions that involve some cash component. • The impact of the proposal on the application of the small business CGT concessions should also be carefully considered e.g. a merger may require all the assets of the merger partner to be included for the purposes of the threshold tests to access small business CGT concessions. • Many companies in the small to medium enterprise sector are structured as companies for asset-protection reasons. As such, in order to ensure broad applicability of the roll-over in this sector, share transactions should be brought within scope. • The ultimate taxing point should be aligned with the disposal of interests in the merged business i.e. crystallisation of the gain. • The interactions with the consolidation regime should be carefully considered. <p>Small businesses are unlikely to approach the Commissioner for a ruling ahead of entering into merger transactions due to the delays involved in obtaining private advice from the ATO. As such, it would be preferable for the law to be clearly drafted and for clear, practical ATO guidance to be issued on the scope and limitations of the roll-over.</p> <p>Specific examples provided by Tax Institute members have been included at Appendix B.</p>
Stakeholder in manufacturing industry (Confidential)	<p>The proposed roll-over is a worthwhile initiative but unlikely to lead to significant merger activity in this industry.</p> <p>The main impediment to merger activity in this sector is the inability to transfer and utilise losses post-merger, as likely merger targets have substantial carry-forward losses.</p>

APPENDIX B: LIST OF EXAMPLES PROVIDED DURING CONSULTATION WHERE ROLL-OVER RELIEF WOULD RESULT IN MERGER ACTIVITY

The following examples were provided through the Board's consultations. In the interests of preserving confidentiality the examples are generically worded. Following further work, the Board has taken the view that to mitigate revenue costs and address integrity concerns its proposal will be narrower in scope, for example being restricted to transactions involving companies. Consequently, several of the examples provided during consultation and described below may no longer satisfy the requirements of the proposed roll-over relief.

Manufacturing industry

Example #1: Supply Chain

Company A, a subsidiary of a major diversified multinational company, provides services to mining entities throughout Australia.

Company A's production operations are primarily located on the Eastern seaboard. As such, in order to satisfy contracts with purchasers in WA, Company A relies on a complex network of sub-contracts and supply agreements with competitors based in WA. These agreements are usually complex and create legal and commercial risks.

If an asset merger roll-over were introduced, Company A could merge its assets and expertise with a WA-based supplier. The merged business would then supply contracts with WA-based purchasers. This structure would lower legal and commercial risks for Company A.

Example #2: Process inputs

Company A is a subsidiary of a major diversified multinational company which utilises Liquefied Natural Gas (LNG) as a major input into its core manufacturing process.

Company A wishes to secure its supply of LNG, however the only way to do so is to purchase Gas from Company B via a long-term supply contract, or acquire Company B.

Entering into a long-term supply contract creates legal and commercial risks for Company A. However, acquiring Company B is not in keeping with Company A (or its parent entity's) strategic objectives.

Company A could seek to acquire an interest in Company B's gas plant processing facility. At present, this option presents a number of tax costs (including capital gains liabilities on deconsolidation).

If an asset merger roll-over were introduced, Company A could contribute assets in return for an interest in Company B's gas processing facility, as taking an ownership interest would better secure Company A's LNG supply.

Example #3: Capital Allocation

Company A is a multinational manufacturing business with a diverse range of manufactured products managed by autonomous divisions within the Group.

All divisions compete equally when it comes to seeking capital allocations from its head office for the purpose of regular maintenance of plant and for potential growth/expansion opportunities.

The IRR of the Group is set by head office to ensure a sustainable growth in returns to shareholders. This typically means that low IRR projects are overlooked.

If an asset merger roll-over were introduced the multinational will be able to contribute the assets of the relevant division to a third party who is prepared to accept a lower IRR with a view to expanding the combined business.

The multinational company will then become a portfolio manager rather than an active manager of the underlying business enabling it to provide strategic support to the combined business.

Digital economy

Example #4

The proposed roll-over would likely be used in the type of scenario where an entrepreneur contributes some intellectual property to a more established player in exchange for shares.

In some cases, the contributor then becomes an employee of the purchaser. Tax is currently an impediment to that type of transaction given that the start-up and its founder are unlikely to have much spare cash or easy access to finance. Impacted transactions are likely to be at the smaller end (single-digit millions in transaction value).

Small business

Example #5

Two businesses in the printing industry are proposing to merge.

One business targets the consumables retail market (printing cartridges). The other business sells large scale digital printers to other sellers for example wholesalers. A merger would have allowed both businesses to expand up/ down-stream.

This merger could progress under current tax laws using a series of back-to-back roll-overs. However, the tax risk attached to this transaction would be high. As such, the introduction of the proposed roll-over would significantly reduce tax risk (and therefore complexity and compliance costs) associated with this merger.

Example #6

A manufacturing business operating as a company and an engineering business operating as a discretionary trust are seeking to merge in order to marry distribution and production functions of the same product. The proposed transaction is an eventual divestment, but subject to a minimum 3 year transition period where the owner of the manufacturing business would retain a stake in the merged business and stay involved as a managing director.

It is not possible to use scrip for scrip roll-over to effect this merger as one of the entities is a discretionary trust.

The proposed roll-over would facilitate this transaction by allowing a deferral of the gain until the end of the transition period such as when the original owner 'realises' his interest in the merged business.

Mining, Oil & Gas industries

Example #7

The oil and gas sector in Australia is characterised by a range of on-shore and off-shore projects which are owned and operated either by a single company or (more commonly) through joint-venture structures between a combination of Australian-based companies, international oil companies and/or national oil companies.

Unincorporated joint-ventures (which are typical of the majority of projects in Australia) is a mechanism used world-wide to allow for the sharing of risk, technical expertise, marketing skills and to spread the high costs associated with oil and gas projects. Each JV is usually subject to a JV agreement which sets out cost-sharing mechanisms and decision making processes and thresholds (usually in accordance with ownership interests).

A significant amount of infrastructure usually needs to be developed in order to progress individual projects. At present, infrastructure is usually not "shared" between projects due to the taxation consequences that arise if projects seek to achieve synergies in terms of efficiency and production capacity through ownership realignments.

However, if the proposed merger roll-over relief were available, investors would be able to re-align their ownership interests (without adverse tax consequences) to more effectively utilise existing infrastructure. This could lead to either increased output or

the more effective use of existing infrastructure (or both). This could also allow for marginal oil and gas fields to be developed.

Example #8

Party A has an existing oil and gas project including interest in a petroleum title and related infrastructure.

Party B has an interest in a separate, undeveloped petroleum title.

Party A and Party B would like to consolidate interests such that Party A provides a partial interest in its petroleum title and infrastructure to Party B in exchange for a partial interest in Party B's petroleum title. Party A and Party B would form a joint venture and produce petroleum from both titles through the jointly owned infrastructure.

At present, the up-front tax cost of this transaction is likely to be a barrier to the transaction itself.

Example #9

Party A has an existing oil and gas project including interest in a petroleum title and related infrastructure. Party B has an interest in a separate undeveloped petroleum title. Party A and Party B would like to consolidate interests such that Party A provides a partial interest in certain existing infrastructure to Party B in exchange for a partial interest in Party B's petroleum title. Party A and Party B would look to develop the undeveloped petroleum title through the existing infrastructure subject to the roll-over.

This assists with alignment of commercial objectives given the owners of the infrastructure would also have ownership in the reserves of the undeveloped reserves.

Example #10

1.57 The proposed roll-over could also apply to the circumstance where Party A may have mineral processing and rail infrastructure but exhausted mineral reserves while Party B could have available mineral reserves but an absence of processing and transportation infrastructure.

APPENDIX C: INTEGRITY ISSUES

The 'Asset merger roll-over' proposal contemplates two types of mergers. The 'base case' is an asset merger combination where company owned assets are merged through participants exchanging interests in assets directly between themselves. The other case is an 'asset for scrip', which involves the transfer of assets into a company in exchange for shares in the company. Each of these mergers raises different tax and integrity issues.

The below table summarises the Board's suggestions for mitigating those integrity issues that should be further considered through a prudent policy and law design process.

	Base case – asset merger combinations	Asset for scrip (AFS) combinations
ELIGIBILITY ISSUES		
1 Ongoing activity participation and/or substantial interest requirement	<ul style="list-style-type: none"> Each participant must hold a percentage interest in their original and acquired active assets. Each participant must have proportional interests in the combined business after the transfer equal to the relative value of the assets the participant contributes. A minimum holding period subsequent to the merger transaction may be necessary. 	<ul style="list-style-type: none"> A minimum 20% interest in the ongoing merged business may be necessary for each merging participant. However, a principle-based fall-back rule for those participants who cannot satisfy the percentage bright line test could be an option so as to not restrict particular industries from accessing the roll-over. <p>The set of indicators for such a fall-back rule could be predicated on the following:</p> <ul style="list-style-type: none"> - board participation - management involvement - a shareholder agreement - participation in expenditure and other committees relevant to the operation of the business - a binding commitment to provide further/ongoing funding

	Base case – asset merger combinations	Asset for scrip (AFS) combinations
		<p>- continued exposure to risk</p> <ul style="list-style-type: none"> • The number of shares received by each participant to the merger should be proportional to the relative value of assets the participant transferred to the company. • Conceptually, a similar ‘proportional interest’ principle should apply when assets are merged into an existing company. (Note: Integrity issues would have to be considered where the existing company has a substantial portion of non-eligible retained assets). • A minimum holding period subsequent to the merger transaction may be necessary.
<p>2 Trading of unrealised losses</p>	<ul style="list-style-type: none"> • No integrity risk identified - unrealised losses are not swapped directly between participants because each participant retains their own cost and allocates it to acquired portion of assets [see below proposed cost adjustment rules]. • In relation to unrealised losses generally, the proposed roll-over relief should not provide the opportunity to accelerate crystallisation of unrealised losses while deferring unrealised gains in relation to a package of assets transferred as part of a merger. To address this, it is proposed that where roll-over is elected, it must apply to all assets transferred. 	<ul style="list-style-type: none"> • A ‘No net loss’ rule may be implemented so that of all the assets transferred in consideration for scrip, there is to be no net loss. • Further consideration could be given to replicating the rule in the Small business restructure roll-over (s.328-470) that disregards a loss on subsequent sale of membership interests to the extent the loss is attributable to the roll-over transaction. • The same general principle that applies to unrealised losses generally in the base case (asset merger) should apply in the asset for scrip combination.

	Base case – asset merger combinations	Asset for scrip (AFS) combinations
3 Non-residents and TARP planning avoidance	<ul style="list-style-type: none"> • If a non-resident exchanges an interest in a TARP asset for an asset that is not TARP, then roll-over provisions could regard the portion of the non-TARP asset received as ineligible proceeds. Pro rata relief could still be available on the portion of any TARP assets the non-resident receives. • Alternatively, roll-over relief could be denied entirely if a non-resident receives a portion of non-TARP assets in exchange. • A third alternative is a deeming rule to ensure a non-resident participant will remain liable to pay tax on capital gains on disposal regardless. 	<ul style="list-style-type: none"> • The same general principles that apply to the base case (asset merger) apply in the asset for scrip combination. • However, a further deeming rule could be considered to ensure that if shares received by the non-resident are initially TARP assets (because the shareholding is greater than 10% and also due to the nature of the underlying assets of the company), then they are deemed always to be TARP assets.

COST ADJUSTMENT RULES

4 Asset tax status shift, i.e. revenue assets vs CGT assets	<ul style="list-style-type: none"> • The tax cost of assets contributed to the merger remains with each participant, and allocated to the portion of assets received in exchange. (This is the approach adopted in the 124-S interest realignment roll-over). • Excluding trading stock from roll-over relief will alleviate integrity risk to some extent. • Further analysis to be done on whether to require a proportional amount of any subsequent gain realised on sale of the asset to be tagged as a revenue gain in relevant circumstances. 	<ul style="list-style-type: none"> • The tax cost of shares received by each participant reflects the tax cost of assets transferred to the company in the merger, being the cost base of CGT assets and adjustable value of depreciating assets. • While it is somewhat unlikely, further analysis is needed in relation to a depreciating asset in the hands of the transferor changing status to become a capital asset in the hands of the company. Analysis is also needed in relation to the converse situation where a capital asset in the hands of the transferor becomes a revenue asset to
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	Base case – asset merger combinations	Asset for scrip (AFS) combinations
	<ul style="list-style-type: none"> Further deliberation is needed in relation to an unrealised capital gain embedded in the portion of a capital asset transferred in exchange for a portion of a revenue asset. This may be disadvantageous to the participant but the participant could choose not to access roll-over relief and realise CGT losses instead. Consideration should be given to the advantageous tax outcome related to CGT cost base becoming depreciable where a portion of a capital asset is transferred in exchange for a portion of a revenue asset. 	<p>the company recipient (for example, a pre-2001 mining right)</p> <ul style="list-style-type: none"> An issue also arises in the transfer of revenue assets in exchange for shares (being capital assets), which needs further analysis. Excluding trading stock from roll-over relief will alleviate this issue to some extent. In a weighing up of whether the risk justifies the associated complexity, further analysis is needed on whether to require a proportional amount of any subsequent gain realised by the transferor on sale of the shares to be tagged as a revenue gain in relevant circumstances.
5 Inheriting asset tax data	<ul style="list-style-type: none"> In adopting the approach taken in the 124-S interest realignment roll-over, the cost should remain with original owner of the asset and the proportion of cost relating to the disposed portion of asset is allocated to the portion of asset acquired. 	<ul style="list-style-type: none"> The Company should inherit tax values of the assets transferred to it in the merger. To this extent, any indefinite deferral opportunity is eliminated. Scrip for Scrip already provides the mechanism with ‘significant stakeholder’ and ‘common stakeholder’ rules. Consideration should be given to importing these integrity rules.
6 Indefinite tax deferral through repeated use of the roll-over	<ul style="list-style-type: none"> No integrity risks identified. 	<ul style="list-style-type: none"> The extent to which the historic cost moves into the company, the indefinite deferral opportunity is eliminated in a straightforward application of the asset for scrip roll-

**Base case – asset merger
combinations**

**Asset for scrip (AFS)
combinations**

over.

- However, there is a potential risk for a cost base uplift through the Consolidations regime to be further considered in the context of subsequent scrip for scrip transactions that also invoke roll-over relief.
-