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Dear Members of the Board

Review of CGT Rollovers

Thank you for the opportunity to participate in group consultations on 27 May 2020 as well as the invitation to provide a written submission in response to the Consultation Guide issued by the Board of Taxation in February 2020, in relation to the Board's review of the Capital Gains Tax (**CGT**) Rollover regime.

Ashurst is a leading global law firm and in Australia (formerly known as Blake Dawson) is one of Australia's largest law firms. The Ashurst tax practice is one of the largest tax practices among the law firms. Ashurst regularly advises clients in public and private mergers and acquisition and restructuring transactions.

This letter sets out our comments in response to the questions asked in the Consultation Guide, as well as additional issues we consider relevant to such a review. We note that these comments are only our initial feedback in the consultation process, and look forward to further opportunities to engage as the review continues. There will no doubt be more specific comments to be made and our submissions may evolve as consultation continues on this topic.

1. EXECUTIVE SUMMARY

CGT rollovers are a particularly important area of taxation law. The kinds of transactions to which CGT rollovers are relevant often involve very significant sums and defining moments for a business. Rollovers therefore play a significant role in allowing businesses to expand and achieve their strategic aims, which in turn supports a strong Australian tax base.

With this in mind, it is certainly the case that the existing suite of CGT rollovers is in need of review. Many of the issues and problems considered by the Consultation Guide are widely known and have become particularly contentious in recent years. As such, we are very supportive of a review of the current law in this area.

However, at the same time, it must also be borne in mind that the existing set of rollovers have been reviewed and amended over time to address very specific and legitimate issues, unique to the nature of each rollover. Accordingly, we would treat with caution an approach that advocates the complete redrafting of the rollover regime into three, principle-based categories, as suggested in the Consultation Guide. Rather, we would suggest that any review should be directed towards addressing the gaps and potential failures of the current rollovers, as well as certain interpretive issues that have arisen in recent years.

Insofar as this might not allow for the flexible development of the law, and may potentially create unfairness from a policy perspective as business practices change over time, we would be supportive of the introduction of one or more additional rollovers with a principle-based test. That is, to create a two-tiered approach:

1. Regard would first be had to whether a rollover is available under the established categories; and

2. the new, principle-based rollovers would then serve as a fallback, "last resort" rollovers. Parties to transactions that do not meet the very detailed criteria of a specific rollover, but which otherwise meet the policy rationale for which rollovers are available, would be able to seek a rollover under one of these new categories. This will be discussed further at paragraph 2.4.

This two-tiered approach would serve to preserve the existing CGT rollovers (and the valuable interpretive material that has developed with them), while allowing for increased flexibility in the development of the law.

We have set out below our views and comments on some of the questions posed in the Consultation Guide, including areas of difficulties with the current set of rollovers.

In addition, as set out in this letter, we consider that there are two matters that can be dealt with on an urgent basis as given their immediate impacts on businesses right now and because the policy position with respect to the issue we consider is clear, is an issue existing in the current rollover regime and can be fixed with a relatively simple legislative amendment:

- Technical amendments to allow access to rollovers for AMITS; and

- Preservation of existing tax cost base of business assets following rollover under the tax consolidation regime where the rollover has resulted in historic cost base of shares to be inherited by the acquiring entity.

We urge the Board of Taxation to raise these two issues with the Government immediately rather than to wait for the conclusion of the CGT rollover review. Such fixes would be warmly welcomed by the business community.

2. ANSWERS TO QUESTIONS IN CONSULTATION GUIDE

2.1 Do you agree with the policy considerations outlined in this document? Are there any other policy considerations that should be taken into account? Why?

We do not take issue with any of the policy considerations outlined *per se*. However, it is important that each policy consideration is given its due weight. It might therefore be useful to provide further guidance upon what the dominant policy rationale behind the CGT rollovers is, or should be. All other policy objectives should then be considered with this dominant rationale in mind.

To this end, we would make the following comments with regards to the policy considerations listed in the Consultation Guide:

(a) *That rollover relief should be understood in the context of the equity that CGT provides to the tax system*

We acknowledge that the equity and fairness of the taxation system should be relevant to any review or proposed amendment of taxation law. CGT does perform an important role in this area, particularly in ensuring that taxpayers with more access to capital wealth are taxed on true increases in that wealth.

However, to the extent that the Consultation Guide suggests that "rollover relief can be counter to fairness in that the deferral of the taxing point is not an available option for taxpayers, particularly lower income taxpayers, earning salary and wages", we would suggest that this is overstated.

Rollovers generally involve some recognition that the underlying economic position of the taxpayer has not changed, despite the apparent or legal change in the nature or owner of an asset. This is the realisation-based rationale behind CGT rollovers, and is consistent with a significant policy and jurisprudential consideration that underlies the taxation system as a whole. That is, that tax may be justified where there has been a realised increase in the wealth of the taxpayer. It is not until that increase is realised – brought home to the taxpayer, so that (amongst other things) the taxpayer is in a position to meet their tax liability – that the taxation on that increase should be considered fair.

Bearing this in mind, it would in reality be counter to fairness to impose taxation at a point where no true increase of wealth has occurred for the taxpayer. This is particularly the case where, the increase is notional only (on paper but unrealised) and the taxpayer has not realised the wealth and therefore the cash available to meet the taxation liability that would otherwise arise. In other words, it actually promotes the fairness of the taxation system to allow for deferrals of the taxation point where no realised increase of wealth has occurred. Further, it would not be an appropriate design/policy position for the taxing event on a notional increase in wealth to be driver of a decision to realise the asset so that the tax liability on the notional increase may be funded.

From this perspective, it can also be seen that a deferral of taxation until the point of realisation is *not* an unfair advantage compared with the taxation of income such as salaries and wages, as suggested in the Consultation Guide. The taxation of ordinary income also occurs at the point of the actual increase in wealth of the taxpayer. Accordingly, any consideration of fairness and equity should be focused on whether there has been a real change in the economic position of the taxpayer. That is, whether the taxpayer's apparent increase in wealth as a result of the relevant event has in fact been realised.

Finally, we note that Australia has a high rate of share market participation involving taxpayers with high and low income levels (and even more so when it is considered that much of low income taxpayer's wealth may be accumulated in superannuation savings and participation in investments by those superannuation funds). Lack of roll-overs, particularly affecting publicly listed investments, will adversely affect low income taxpayers to a significant extent.

(b) *That rollover relief should take into account the economic efficiency aims of CGT*

We accept that CGT plays an important role in decision making for businesses when determining whether and where to invest. CGT was introduced to remove the imbalance between the taxation of income and capital, which previously allowed investors to focus on tax-free capital gains. This was to ensure that decisions to invest in the most productive projects would be less influenced by these considerations..

However, we would disagree with the suggestion that CGT rollovers may have a "distortive effect" on the balance that CGT was intended to create. CGT rollovers are directed specifically towards further encouraging the economic efficiency aims of CGT. Where the introduction of CGT served to remove the perceived tax impediment against investing in active projects, by evening the playing field between the taxation of income and capital, it was also recognised that CGT itself could create an impediment against investment in productive projects in certain situations.

Accordingly, rollovers were introduced to reduce the impact of this new impediment. They allow taxpayers to restructure and enter into transactions that encourage the best use of their assets, without being deterred by tax costs. We consider that it is appropriate to recognise that this is a part of practical, commercial decision making, which can co-exist with integrity considerations in, for example, Part IVA.

Accordingly, the review should not start from a point where CGT rollovers are assumed to have a "distortive effect" on the economic efficiency aims of CGT. Rather, the focus should be on how CGT rollovers could be further enhanced to promote their current purpose in this area.

(c) *That rollover treatment can relieve the unfair aspects of involuntary CGT events*

We agree with this policy consideration, but note that it could be expressed more broadly. That is, that CGT rollovers in fact relieve unfair aspects of CGT more generally, where no change in the economic position of the taxpayer has occurred. For involuntary CGT events, this involves some sort of compensation or replacement asset, intended to put the taxpayer in a position as close as possible to the position they would be in had the CGT event not occurred. The way in which rollover relief more generally promotes the fairness of the taxation system has been discussed at paragraph (a) above.

(d) *That rollover treatment can reduce the effects of 'asset lock-in'*

We agree that a policy objective of rollovers is to reduce the effects of 'asset lock-in'. In particular, we agree that rollover relief should promote "desirable business behaviour" and enhance the productivity of the corporate sector.

(e) *That rollover relief should be as simple as possible to promote compliance*

If the aim of simplicity is to promote compliance, this will only be possible where simplicity enhances certainty. However, in an environment in which the subject matter of the law is itself inherently complex, the reduction of the law to simple principles may in fact create uncertainty. It is precisely due to inherent complexity of many business transactions that the current rollovers have evolved in the way that they have, as unintended applications or lack of certainty have been addressed over time.

Accordingly, we do not consider that the issues of complexity in the current rollover regime can be addressed by the redrafting of the entire regime into three, principle-based categories. Rather, we submit that each existing rollover should be considered in its own right, and clarified where necessary. For example, many of the rollovers contain similar tests, with seemingly similar policy objectives. However, these tests are often expressed differently from rollover to rollover, with no ascertainable policy reasoning behind the distinction. Examples include the market value and proportionality tests that apply for many replacement asset rollovers, which are discussed in more detail at paragraph 2.3(a) below. We would support a recommendation that these tests, and other tests that are common between different rollovers, should be streamlined and expressed in the same terms throughout the rollovers to which they are relevant.

Practical amendments such as this would achieve a greater benefit in clarifying and simplifying the CGT rollover regime than would be achieved by redrafting the entire regime into a more nebulous, principle-based suite of rollovers. In addition, guidance on how the existing rollovers should interact (in a way which promotes the policy objectives) may also be appropriate.

As will be evident from our comments above, we consider that a significant consideration that informs the above policy objectives is that of the underlying economic position of the taxpayer. That is, that rollovers should provide relief where the underlying economic position of the taxpayer has not changed (in a substantive or economic sense, as opposed to an apparent or legal sense). This is consistent with the realisation-based rationale behind CGT and promotes the fairness of the overall system.

Additionally, we consider that regard should be had to the policy considerations behind the scrip-for-scrip rollover under Subdivision 124-M. Although this rollover was introduced in the context of a different policy discourse to other rollovers, we consider that this has changed (or at least, should change) the policy landscape of the rollover regime more generally. In particular, Subdivision 124-M was aimed to prevent innovative businesses moving to more favourable jurisdictions to raise capital.[1] The Explanatory Memorandum to the Bill introducing the subdivision stated that the rollover would "enhance the functioning of, and value creation by, the corporate sector in Australia."[2]

We would suggest that this policy objective of enhancing the functioning of the corporate sector, and making Australia an attractive jurisdiction for investment, should be another underlying policy consideration for a review of CGT rollovers. Accordingly, we submit that the two dominant policy considerations for this review should be:

1. Rollover relief should be available where there is no real change in the underlying economic position of the taxpayer (in a substantive or economic sense, as opposed to an apparent or legal sense); and

2. Rollover relief should promote flexibility, economic efficiency and productivity in the investment and allocation of capital by businesses, so as to support a strong Australian tax base.

All other policy considerations should be considered with these two dominant policy considerations in mind.

2.2 **What framing principles would be appropriate for rationalising the three categories of rollovers into more principles-based rollovers?**

For example, does the concept of 'involuntariness' adequately capture the unfair circumstances in which rollover should apply?

As mentioned above, we would caution against an approach that advocates the complete redrafting of the rollover regime in favour of three, principle-based categories. The difficulties with this approach are apparent in the fact that the Consultation Guide itself was not able to successfully divide the existing rollovers into three categories. Rather, the small business rollover in Subdivision 152-E is listed as a stand-alone, "unique" rollover, without any real explanation for this distinction.

Further we have concerns that principles based rollovers do no provide sufficient clarity and certainty for public M&A transactions such that they cannot proceed without a binding Australian Taxation Office ruling for the securityholders – this creates more inefficiencies in the system – either delaying or complicating the implementation steps for the transactions and/or become an impediment for proceeding with the transaction due to overall perceived deal uncertainty. The ruling processes can lead to unexpected outcomes, as it can be seen with recent demergers transactions.

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[1] In response to the Commonwealth ('Ralph Committee'), *Review of Business Taxation, A Tax System Redefined*, Final Report, 1999.

[2] Explanatory Memorandum, *New Business Tax System (Capital Gains Tax) Bill 1999*, [2.5].

We would instead advocate a review of each rollover in its own right. Such a review should, of course, be informed by the policy considerations as expressed at paragraph 2.1 above, and in particular the dominant policy considerations suggested there.

Further, insofar as we would support the introduction of any new, principle-based rollovers (as discussed at paragraph 2.4 below), we would not suggest that this be based on the three categories suggested in the Consultation Guide. On this point, we consider that the distinction between the suggested categories appears artificial when regard is had to the dominant policy considerations suggested above, at paragraph 2.1.

In particular, questions of 'voluntariness' or 'involuntariness' become irrelevant where regard is had to the underlying economic position of the taxpayer. This perspective reveals that CGT rollovers in fact relieve unfair aspects of CGT more generally, as discussed at paragraph 2.1(c) above. Accordingly, we would suggest that any new, principle-based rollovers should have as their framing principles the two dominant policy considerations suggested at paragraph 2.1 above.

2.3 **Are there any deficiencies and limitations in the current suite of rollovers that can be addressed by a more principles-based approach to rollover relief?**

There are a variety of problematic elements with the current suite of rollovers that would benefit from a review. However, as discussed above, we would suggest that these should be addressed each in their own right, as opposed to being replaced by a new suite of principle-based rollovers.

A review on this basis should look at both of the following:

- issues with the design and practical application of the rollovers as they currently stand; and
- gaps in the subject matter of the rollovers and how they could be addressed or extended.

We now set out comments on each of these aspects below:

(a) *Issues with the design and practical application of the rollovers as they currently stand*

Many of the rollovers contain similar tests, with seemingly similar policy objectives. However, these tests are often expressed differently from rollover to rollover, with no ascertainable policy reasoning behind the distinction. For example, many of the replacement asset rollovers contain market value and proportionality tests, which seem to be intended to achieve the same thing, but are each worded slightly differently.

Examples of this difference in wording for similar tests include:

- Trust to company rollover in Subdivision 124-N:
    - o Market value test: the market value of the replacement interests in the transferee company must be "at least substantially the same" as the market value of the interests previously held in the transferring trust;

  - Proportionality test: each entity that owned interests in the transferring trust must own replacement interests in the transferee company "in the same proportion" as it owned those interested in the transferring trust;

- Interposition of a holding company rollover in Division 615:

  - Market value test: the proportionate market value of each exchanging member's shares in the interposed company must be "equal to" the proportionate market value of interests previously held in the original entity; and

  - Proportionality test: each exchanging member must own a "percentage" (as opposed to "proportion", although there does not seem to be any reason for the different wording) of shares in the interposed company that is "equal to" the percentage it owned in the original entity.

- Demerger relief in Division 125:

  - Market value test: the original owners of interests in the head entity must have "the same" proportionate market value of interests in the head entity and the demerged entity as previously held in the head entity;

  - Proportionality test: the original owner must also acquire "the same proportion, or as nearly as practicable the same proportion" of new interests in the demerged entity as previously held in the head entity (we note that this test is almost impossible to interpret clearly in the context of the provisions and lead to interpretations that do not promote the original policy aims and situations that were intended to be covered);

The overall intention of each of these provisions appears to be to ensure that the taxpayer is in the same economic position, from both a market value perspective and a proportion of ownership perspective, before and after the relevant event. Differences in wording such as "the same", "equal", "substantially the same" and (perhaps worst of all) "at least substantially the same" create confusion on both an interpretive and practical level when applying the rollovers. Accordingly, we would support a recommendation that these tests, and other tests that are common between different rollovers, should be streamlined and expressed in the same terms throughout the rollovers to which they are relevant.

(b) *Gaps in the subject matter of the rollovers and how they could be addressed or extended*

(i) *Interpretive issues regarding the demerger rollover and back-to-back rollovers*

An issue of particular concern is the recent, perceived change in the ATO's approach to the demerger rollover (Division 125) and back-to-back rollovers. The ATO has historically considered only the specific demerger transaction when applying relief under the demerger rollover (ie subsequent transactions involving the demerged entity have not been considered relevant).

However, *Draft Taxation Determination TD 2019/D1*, has been seen to essentially reverse this approach. The ATO is now taking a broader interpretation of the word "restructuring" in the demerger rollover, such that it is now said to include "all the steps and transactions which are connected to, required to give effect to or are expected to result from the disposal".

This is combined with a newly restrictive interpretation of the requirement that the owners of interests in the head entity receive shares in the demerged entity "and nothing else". This is said by the ATO to mean that later transactions involving the demerged entity (and any consideration received under them) are relevant, "whether or not legally interdependent". This new approach will be significant for many types of transactions that may commercially be desirable to occur at or about the same time as the demerger (eg, additional capital raising post-demerger to allow the demerged entity to access separate capital (which is often the type of commercial benefit sought to be achieved by the demerger)) may cause the demerger relief to be unavailable. Even in the case of multiple rollovers that follow the demerger (and is prevented by the "and nothing else" requirement), when viewed as to the policy objectives of rollovers, it is not clear why such transactions should not be given rollover relief.

Accordingly, we consider that it would be extremely helpful to re-align demerger provisions and introduce new rules on the interaction of rollovers for reorganisations and transactions that involve multiple steps based on the dominant policy considerations suggested at paragraph 2.1 and, accordingly, enabling such transactions to occur.

(ii) *Inadvertent exclusion of AMITS from some rollovers*

Some CGT rollovers involving trusts are only available where CGT event E4 is capable of applying to the trust. This has historically been understood to be a reference to the fact that CGT event E4 does not apply to discretionary trusts (as per the views of the ATO expressed in TD 2003/28).

However, since the introduction of the attribution managed investment trust (AMIT) regime in 2016, CGT event E4 does not apply to non-assessable payments by AMITs to unitholders. Rather, a separate CGT event E10 applies. Although CGT event E10 has much the same effect as CGT event E4, this creates a technicality that excludes AMITs from accessing some CGT rollovers. The AMIT provisions were a significant and complex range of reforms introduced for the funds industry and it seems that there was an unintentional oversight at the time in not adjusting the rollover provisions to cater for introducing E10 and removing E4 for AMITs.

We submit that it is clear that AMITs meet all the policy considerations for which these rollovers would otherwise be available to a trust. Accordingly, we submit that an urgent corrective technical amendments (such as including reference to CGT event E10 as well as CGT event E4 wherever applicable) to ensure that AMITs can access these CGT rollovers should be made as soon as possible and with retrospective effect.

We are aware of at least 2 large transactions where this oversight had recently affected AMITs who otherwise would have utilised the relevant rollovers. We are confident that there are many more examples where this oversight has had an impact on transactions. We also understand that a number of industry bodies in the funds management space have raised concerns over this oversight. We urge the Board of Taxation to raise this issue with the Government as a matter of priority.

(iii) *Limitations for transactions involving trusts more generally*

This review should also consider gaps in the accessibility of existing rollovers for trusts more generally. In particular, regard should be had to increasing access to rollovers for:

- Interposing a trust above another trust or a company (it is possible to obtain a rollover where a company is interposed above a trust or another company under Subdivision 615, but this is not generally available for interposing trusts – this for example can be limited to unit trusts (which is a common business structure alternative to companies, in order to address integrity concerns over broader range of trust));

- Transfer of assets between wholly owned trusts (a rollover is currently available only in limited circumstances under Subdivision 126-G – this rollover has many technical difficulties with its operations and should also be reformed. Areas such as rigid requirements with regards to mirror elections is one example); and

- Transfer of assets from a company to a trust (a rollover is available for the transfer of assets from a trust to company under Subdivision 124-N, but not vice versa).

We recognise these limitations for trusts are likely based on a general policy that promotes corporate structures over trust structures, due to the perceived tax benefits that come with the trust structure. However, as mentioned above, unit trusts are commonly used business structure and alternatives to company and we submit that the current review is an opportunity to consider whether this distinction should continue to apply for CGT rollovers and especially for unit trusts. In particular, where the dominant policy considerations suggested at paragraph 2.1 are met, and having regard to the integrity provisions of Part IVA (as discussed at paragraph 2.6 below), we would challenge an assumption that increased access to rollovers for trusts is undesirable from a policy perspective.

(iv) *Limitation of relief to interests held on capital account, and whether it might be appropriate to extend relief to income tax more broadly*

The majority of rollovers exclude trading stock and assets held on revenue account. While this may make sense at a glance, as the rollovers are concerned with deferring CGT liability, we would suggest that consideration should be had as to whether rollovers could be expanded beyond CGT.

There is precedent for this extension in some of the existing rollovers. In particular, the rollover for the interposition of a holding company (Division 615) and the small business restructure rollover (Subdivision 328-G) both allow for the deferral of tax consequences on the transfer of a revenue asset. The profit or loss on the transfer is essentially disregarded in much the same way as capital gains or losses are disregarded.

If the dominant rationales behind rollovers are that an apparent or legal change of interests should not be taxable where there is no substantive change in the economic position of the tax payers, and that rollovers should promote the productivity of the corporate sector, then there is no reason that rollovers should not also be available for revenue assets where these considerations are met.

(v) *Limited preservation of consolidated cost base for most rollovers*

Most rollovers do not allow for the preservation of consolidated cost bases where a consolidated group is involved. This leads to complications where, for example, the cost base adopted is less than the market value of all the assets in the hands of the ultimate holding entity. This lesser cost base is spread across assets with a higher value in the hands of the holding entity, which has flow on effects for the members of the consolidated group.

We deal with this issue in more detail at paragraph 2.7 below.

2.4 **Can the system benefit from any additional categories of rollovers? To what extent would any additional rollover category encourage the active use of assets in the economy and maintain the integrity of the system generally?**

While we do not consider a complete, principle-based redrafting to be appropriate, we would not be opposed to the introduction of one or more new, principle-based rollovers in addition to the review and clarification of the existing rollovers.

Any such new rollovers would operate as secondary or "last resort" rollovers, to be available only where no other rollover applies. The overall number of new rollovers should be limited to those strictly necessary to fulfil the relevant policy objectives. In particular, they would have as their framing principles the two dominant policy considerations suggested at paragraph 2.1. That is:

1. Rollover relief should be available where there is no real change in the underlying economic position of the taxpayer (in a substantive or economic sense, as opposed to an apparent or legal sense); and

2. Rollover relief should promote flexibility, economic efficiency and productivity in the investment and allocation of capital by businesses, so as to support a strong Australian tax base.

The second principle in particular could be expressed using examples to demonstrate that the new rollover should promote the active use of assets in the economy. As principle based drafting is inherently broad brushed, this could in fact create uncertainty and room for differing interpretations. As stated above, we are concerned that this level of uncertainty (which may be relatively low) create an unacceptable level of risk for the types of significant transactions that such rollovers often are needed for which means the rollover acts as a deterrent rather than an enabling tool for such transactions. Hence, we suggest the two tier approach. Further, we would also suggest the use of safe harbours in the principle based rollover to provide some level of certainty in areas which do not pose significant integrity risks.

These new rollovers would create a two-tiered approach, which would preserve the existing CGT rollovers, while allowing for increased flexibility in the development of the law to meet new situations. It would be subject to the same integrity considerations as those applicable to rollovers generally, as discussed at paragraph 2.6 below.

2.5 **Are there any redundant rollovers?**

We do not have any comments on this matter at this point of the consultation process. While as a practice we do not have need to provide advice on all the listed rollovers, we note that our practice and our client base is not representative of all taxpayer groups.

2.6 **What do you consider to be the main integrity risks with the current suite of rollovers? Should specific integrity/purpose rules be built into the CGT rollovers?**

Integrity or purpose-based rules, such as rules regarding the "genuineness" of a particular transaction, may be of limited assistance in the CGT rollover regime and may in fact increase confusion when it comes to interpretation. We consider that the general provisions of Part IVA are sufficient to provide the necessary limitations in this respect.

In particular, if the Commissioner is of the opinion that the dominant purpose of a transaction is to obtain a rollover in a contrived manner, then it would be open to the Commissioner to make a determination under Part IVA. Under this approach, the Commissioner must have regard to the factual matrix surrounding the specific transaction including commercial drivers behind a specific plan for a reorganisation.

2.7 **How does the interaction of other aspects of the tax system, such as the tax consolidation regime, impact the decision to choose a rollover? Do these interactions create favourable or unfavourable outcomes?**

A significant issue in this area is that many of the CGT rollovers generally do not allow for the preservation of consolidated cost bases where a consolidated group is involved. Rather, the acquiring entity inherits the historical cost base of shares of a subsidiary entity which then leads to significant cost base issues when this historic and likely low cost base is used for the tax consolidation cost setting rules in Divisions 701 and 705 of the ITAA 1997. That is, thiis historical cost base must be allocated to the acquired assets in the order prescribed under the cost setting rules. Assets such as cash and receivables are allocated a cost base at value. The remainder of the joining entity's cost base is then apportioned between the remaining assets in proportion to their present market value.

This leads to unfair outcomes where the cost base adopted of certain business assets is less than the existing pre-transaction cost base of the business. While the overall cost base of assets is the same, the cost base is skewed towards cost base of assets that are not turned over or used/wasted in the business (such as goodwill). For example, recently purchased trading stock may suddenly be given a cost base substantially lower than its cost, leading to an immediate tax cost upon its sale in the ordinary course of business. Similar tax effects occur with respect to depreciable fixed assets or working business assets.

This issue has been acknowledged and dealt with in respect of the following rollovers:

- *Rollover for the interposition of a holding company under Division 615:*

  Following a Board of Taxation review in 2013, the law was amended as per the Board's recommendation, so that "where a new holding company is interposed over an existing tax consolidated group under a restructure, the old tax consolidated group is taken to continue to exist with the new holding company being taken to be the new head company of the old group without any exit or entry tax cost setting calculations being required."

- *Scrip-for-scrip rollover in Subdivision 124-M:*

  Similarly, some allowance was made for this issue in respect of the restructure provisions in the scrip-for-scrip rollover in Subdivision 124-M when the restructure provisions were introduced. The consolidation rules specifically provide, at s 715-910, that Division 701 is disregarded for arrangements that are restructures under s 124-784A for the purposes of the scrip-for-scrip rollover. This means that the cost setting rules are disregarded for the purpose of working out the cost base of the acquiring entity under s 124-784B.

> However, this is not the case with all rollovers under subdivision 124-M, this issue has not be fixed for cost base inherited under the significant stakeholder/common stakeholder provisions and should be so fixed.

While the above examples should definitely be considered the correct outcomes, they have very limited application. The provisions in Division 615 are unique, and section 715-910 is only relevant to the specific restructure provisions in the scrip-for-scrip rollover, which themselves are limited to quite specific situations. However, the same issue arises in many other instances where the lower, historical cost base is inherited.

Another significant example of such policy deficiency is the demerger rollover in Division 125. Measures to remove the application of the cost setting rules for demergers of consolidated groups were announced on 27 October 2006, by then Assistant Treasurer Peter Dutton. However, this was never enacted under the Coalition Government at that time. The Rudd Government in 2008 announced that they were reviewing the many tax measures announced but not enacted by the previous Government, with a view to implementing many of them. However, this particular amendment was never enacted and traction for change was unfortunately lost.

There is no clear policy rationale as to why, when this is a widely known problem with the interaction between CGT rollovers and the consolidation provisions, the issue has only been rectified in respect of the very limited situations mentioned above. We consider that similar treatment should be extended to all rollover situations that have the same problem.

We consider that this issue is a relatively simple legislative fix – to allow certain working business assets to maintain its existing tax cost base (eg, trading stock, current assets, fixed assets, tangible assets and purchased intangible assets) and for the excess to be spread across remaining assets and allocated a cost base relative to their market value.

We note that the fix in s.715-910 is not suitable to all rollovers as many transactions will not involve a head entity – for example in many restructures, it results in entities leaving a tax consolidated group with a fresh choice to be made by the exited member as to whether to tax consolidate. Currently, this tax cost base issue has also been an impediment to choosing tax consolidation for such entities which is another inefficient outcome of the consolidation/ rollover interaction issue.

For this discrete issue, we urge the Board of Taxation to raise this issue with the government for a fix as a matter of priority as it is an ongoing and existing issue with rollovers regardless if rollover reform is undertaken.

2.8 **Given grandfathering of pre-CGT assets is a noted source of complexity in the CGT regime, should the pre-CGT status of assets continue to be preserved in connection with rollovers?**

We are of the opinion that the continued grandfathering of pre-CGT assets is an issue that should be dealt with in the context of CGT as a whole. We do not consider it appropriate to suggest that a different approach should be taken in respect of CGT rollovers only. In particular, there should be consistency on this issue across the CGT regime. To make changes in respect of CGT rollovers alone would create inconsistency and increase the complexity of the entire regime, which would be counter to the purpose of this review. Accordingly, this is a question that should be addressed in a separate review, if at all.

On this point, we note that we do not consider such a review to be necessary. In practice, we have not seen pre-CGT assets to be problematic or cause further complexity in transactions (whether in the specific context of CGT rollovers or otherwise). Further, we consider that the continued preservation of pre-CGT status for these assets is consistent with the policy and principles behind rollovers. Where there is no real change in the economic position of the taxpayer, in the sense that there has been no realised increase in the taxpayer's wealth, it would be counter to fairness to bring such assets into a regime founded on realisation-based principles.

2.9 **Can any changes be made to simplify the administrative and compliance obligations for taxpayers (particularly 'mum and dad shareholders') where a rollover occurs?**

We do not have any comments on this matter at this point of the consultation process.

3. CONCLUSION

We do not consider that a complete redrafting to introduce a new suite of principle-based rollovers would be appropriate. Rather, we submit that each existing rollover should be reviewed and clarified in its own right. The review should have regard to the gaps and potential failures of the current rollovers, such as:

- The need for technical amendments to allow access to rollovers for AMITS;
- The opportunity to establish a more enabling approach to the treatment of transactions involving trusts and revenue assets; and
- The need to rectify the contentious interpretive issues that have arisen in recent years.

In addition, we would support the introduction of one or more additional rollovers with principle-based tests, to address issues of flexibility and changing business practices going forward. The overall number of such new rollovers should be limited to those strictly necessary to fulfil the relevant policy objectives.

The review on this basis, and any new principle-based rollover considered, should be informed by the policy considerations as expressed at paragraph 2.1 above and, in particular, the following dominant policy considerations:

1. Rollover relief should be available where there is no real change in the underlying economic position of the taxpayer (in a substantive or economic sense, as opposed to an apparent or legal sense); and
2. Rollover relief should promote flexibility, economic efficiency and productivity in the investment and allocation of capital by businesses, so as to support a strong Australian tax base.

In addition, we consider that there are two matters raised above that can be dealt with on an urgent basis as the policy position is clear, is an issue existing in the current rollover regime and can be fixed with a relatively simple legislative amendment:

- Technical amendments to allow access to rollovers for AMITS; and
- Preservation of existing tax cost base of business acquired assets following rollover under the tax consolidation regime where the rollover has resulted in historic cost base of shares to be inherited by the acquiring entity.

Such fixes would be warmly welcomed by the business community.

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If you have any queries on any of our comments above, please contact Vivian Chang at vivian.chang@ashurst.com.

Yours faithfully,

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