Partner: Vivian Chang
Direct line: +61 2 9258 5732
Email: vivian.chang@ashurst.com
Contact: Steve Whittington
Direct line: +61 2 9258 6547
Email: steve.whittington@ashurst.com

Ashurst Australia
Level 11
5 Martin Place
Sydney NSW 2000
Australia

GPO Box 9938
Sydney NSW 2001
Australia

Tel +61 2 9258 6000
Fax +61 2 9258 6999
DX 388 Sydney
www.ashurst.com

19 February 2021

BY EMAIL: CGTRollovers@taxboard.gov.au

Board of Taxation Secretariat
The Treasury - Melbourne Office
Level 6, 120 Collins Street
Melbourne VIC 3121

Dear Members of the Board

Review of CGT Rollovers

1. INTRODUCTION

Thank you for the opportunity to participate in group consultations on 12 February 2020 as well as the invitation to provide a written submission in response to the Consultation Paper issued by the Board of Taxation (the **Board**) in December 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 certain questions asked in the Consultation Paper, as well as additional issues relevant to the review. Following our participation in the group consultations on 12 February 2021, we understand that the Board is potentially adopting the following approach with respect to its recommendations with respect to the CGT Rollover review:

1. As the first phase, to identify problems or anomalies with the existing set of Rollovers that can be addressed legislatively to ensure that the Rollovers are operating appropriately; and

2. As the second phase, to advocate for the introduction of a more general business restructure rollover along the lines set out in the Consultation Paper.

In principle, Ashurst supports the two phase approach in the light of the many design and implementation complexities associated with replacing certain rollovers with a more general business restructure rollover. Accordingly, we have set out our submissions in two parts reflecting the two phases referred to above.

We note that these comments are only our initial feedback with respect to the Consultation Paper, and we 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.

2. PART A: AMENDING EXISTING ROLLOVERS

We consider that the following anomalies with the existing set of Rollovers should be addressed by way of legislation as a matter of urgency:

- A significant issue with respect to the scrip-for-scrip rollover and the associated common/significant stakeholder provisions is the absence of a provision allowing for the preservation of consolidated cost bases where a consolidated group is involved. For example, if an acquiring entity inherits the historical cost base of shares of a subsidiary entity (notwithstanding that it has paid market value in the form of scrip for the assets), significant cost base issues can arise when this historic and likely low cost base is used for the tax consolidation cost setting rules in Divisions 701 and 705.

  In particular, 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 may be 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 problem has been solved in certain circumstances (see, for example, section 715-910), but has not been solved in the context of the application of the common/significant stakeholder provisions. We consider that a similar approach to that provided for in section 715-910 should be available in the common/significant stakeholder scenario.

- Some CGT rollovers involving trusts (particularly, demerger rollover in Division 125 and trust cloning rollover in subdivision 126-G) 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). 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 certain CGT rollovers.

  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. With respect to Question 25 of the Consultation Paper, we consider that some of the requirements contained in the trust cloning rollover (particularly related to tax elections) should be considered in further detail in the AMIT context.

- Certain CGT rollovers exclude trusts more generally, notwithstanding that there is no rationale for the exclusion of trusts (particularly, trusts for which CGT event E4 or CGT event E10 is capable of happening). For example, the following rollovers should be expanded to include trusts:

  - 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);

    - Transfer of assets between wholly owned trusts (a rollover may currently available only in limited circumstances under Subdivision 126-G – this rollover has many technical difficulties with its operations, such as rigid requirements with regards to mirror elections).

- Certain CGT rollovers which are available to trusts contain greater limitations than the equivalent rollovers for companies. For example, scrip-for-scrip rollovers involving a trust that is a member of a wholly-owned group allow the issuance of units only out of the immediate parent entity and not the top entity of that group. We consider that replacement units from a top unit trust of the wholly-owned group should be permitted.

- The demerger rollover should be amended to ensure that pre- and post-demerger activities (such a post-demerger capital raise) which present no mischief from a tax perspective do not result in a rollover not being available (as a result of the ATO's approach as set out in Tax Determination TD 2020/6).

- The majority of rollovers exclude depreciating assets, trading stock and assets held on revenue account. Consideration should be given to whether rollovers should be expanded more generally beyond CGT as a means to facilitate commercial restructures. 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.

2. PART B: INTRODUCTION OF A GENERAL BUSINESS RESTRUCTURE ROLLOVER

With respect to the introduction of a general business restructure rollover, our submissions are as follows:

- (**Question 1**) With respect to Question 1 of the Consultation Paper, we support the introduction of a general business restructure rollover, and generally agree with the articulation of the benefits of such an approach as set out in the Consultation Paper. To elaborate, we consider there would be material advantages to adopting a "black box" approach that enabled the requirements to be tested at particular times (e.g., after the completion of a series of steps) in determining the availability of a rollover, as it should reduce the current form over substance approach in certain highly prescriptive rollovers (such as Division 615), while also enabling transactions that would currently comprise multiple back to back rollovers (without the associated risks).

  However, we also consider that replacing a series of quite different rollovers with a general rollover, which caters for all of the relevant circumstances, and also corrects for identified deficiencies with the current rollovers, is an ambitious task. Accordingly, we consider that, at least as an interim measure, the existing rollovers should be retained even where a general business restructure rollover is available, with a post-implementation review to consider whether the interpretation adopted with respect to the general business restructure rollover operates as intended in all of the relevant circumstances and the existing rollovers are no longer being relied upon. Only in these circumstances should the relevant specific rollovers be repealed. We suspect, for example, that some of the complexities associated with a disaggregation of steps to analyse a scrip for scrip transaction may give rise to complexity, such that it may be worth retaining a standalone scrip-for-scrip rollover even where such a rollover can also be claimed under the general business restructure rollover provisions.

- (**Comment on principles in Chapter 2**) With respect to the principles, we consider that principle 2 (rollover should be available to relieve inefficient asset lock-in for business where there is strict continuity of economic ownership) is too narrow to reflect business realities and could prevent the role of rollovers in facilitating transactions with economy wide benefits (principle 3). To elaborate:

  - Business restructures occur in the context of broader business strategies and rarely in isolation in the pure form that principle 2 requires. To realise business objectives, restructures often occur with other transactions due to synergistic or business/cost efficiencies . Typically, we submit a rollover should be available to the restructure part of the business strategy even where it occurs as part of the broader strategy which, once fully implemented, would not meet the rollover requirements. In other words, for example, there is not a general mischief in obtaining a rollover for demerging an entity where there is a plan for that demerged entity to raise capital; similarly, there is not a general mischief in undertaking a series of steps for which rollovers are available to create a group of entities that are then sold (with the sale constituting a CGT event that is not disregarded under a rollover).

  - Certain existing rollovers, such as scrip for scrip rollover, do not accord with principle 2. That is, there is a change of economic ownership by asset, although there may not be a change of economic ownership by value. We consider this evidence that principle 2 needs to be broadened and should not be the only reason to justify why a rollover should not apply In particular, principle 3 (relief for transactions involving a change in the underlying economic ownership of assets should be predicated on evidence of additional economy-wide benefits for Australia) may conflict with principle 2 and should be given equal weight with (arguably, should take precedence over) principle 2.

- We consider that principle 4, particularly with respect to the assertion that "relief would not be available for the demerger of a trust by a company, as this would allow profits of the corporate group to be distributed to the ultimate shareholders in a more tax advantages way", is too broad and over simplified. We do not consider that it is necessarily true in all circumstances that trusts are more tax advantageous than companies (as may be inferred, for example, by the fact that most business activity occurs through companies rather than trusts). To elaborate:

  - Whether a trust is a more advantageous entity structure will depend on a range of factors, including the nature of the underlying business, the share/unit holders, and the marginal tax rates of those share/unit holders, among others.

  - Even where, conceptually, a lower tax burden may arise, that is more likely to be a temporary difference rather than a permanent difference (e.g., tax deferred distributions are more likely to arise in a trust context, but ultimately that should represent a timing difference as compared to a corporate structure).

  - Although it may be conceptually possible to achieve a lower rate of tax in a particular period by way of a trust rather than company structure, that will generally necessitate distributing an amount at least equal to net income to unitholders (which itself may be adverse to the underlying business).

- We consider that the appropriateness of principle 6, that transactions that would qualify for single entity treatment if undertaken by members of a consolidated group should generally not receive rollover, is problematic – particularly where other aspects of the proposal would represent an impediment to the formation of tax consolidated groups (relating to the cost base of acquired interests under scrip for scrip rollovers, discussed below). We also consider that while this principle is consistent with certain existing rollovers (e.g., subdivision 126-B), it is inconsistent with other rollovers (i.e., subdivision 124-M).

- On page 17 of the Consultation Paper, the list of rollovers that are proposed to be replaced by the general business restructure rollover would appear to be able to be broadened, including to cover subdivision 124-Q and subdivision 126-G. As a matter of principle, we can see no reason why these have been excluded (especially given that certain other rollovers which are of a different nature, such as subdivision 124-M, have been included).

- (**Question 4**) The Board's proposed first step in the business restructure roll-over model – identifying the relevant business restructure – carries the same interpretation issues that has caused controversy among the business community regarding the ATO's approach to (for example) the demerger rollover. To take an example, it is unclear what the mischief is where an entity undertakes a demerger of a subsidiary (for which a rollover is available), and that demerger is then followed by a pre-ordained capital raise by the subsidiary. This has clearly different commercial outcomes from (for example) a sale of part of the interest (i.e., one provides capital to the former subsidiary whereas the other does not) such that it should not be regarded as a disguised sale, and there are a range of other regimes that would prevent the capital raising from effecting a de facto sale (e.g., the value shifting provisions). Accordingly, we consider that terms like "restructure" with storied interpretation histories should be avoided in the interests of principles associated with good tax policy design – particularly, providing businesses and taxpayers with the certainty that is required to undertake restructures, and ensuring the relevant provisions are capable of applying with a reasonable degree of certainty without ATO confirmation (which itself can lead to time delays and compliance cost issues).

- (**Question 5**) We do not consider the proposal that a "business" can exclude particular CGT events from the restructure for the purposes of applying the general rollover (as is proposed on page 20 of the Consultation Paper) to remedy the identified issue (although we generally agree that allowing taxpayers to exclude certain CGT events from the restructure is a desirable feature), since:

  - A business does not have a CGT event, only taxpayers have a CGT event, and the identity of the taxpayer may change. To take an example, a demerger followed by a sale by the shareholder results in a CGT event not to the "business", but to two different taxpayers;

  - Certain ancillary steps may not give rise to a CGT event (and thus cannot be excluded under the proposed approach), notwithstanding there is no identifiable mischief associated with them (e.g., post-demerger capital raise). In this regard we find Figure 1 particularly confusing – i.e., the "Eligible Restructure" includes Stage 3, which involves capital raisings and/or sale of shares in either the head company or the demerged company. With respect to the capital raising, it is not clear to us what the relevant CGT event is. With respect to the sale of shares in either entity, it is not clear why this would be eligible for a rollover (unless, for example, it occurs by way of a scrip for scrip exchange). Accordingly, we consider that the proposal to exclude only certain CGT events (and not ancillary steps) will only operate as intended where the concept of the "restructure" is more precisely defined in a manner that excludes certain ancillary steps.

- (**Question 7**) We consider that the 12 month rule may not be sufficient. Further, we note that the timing of the first CGT event may not be clear in all cases (at least initially). For example, CGT event A1 requires a disposal, but the CGT event happens when the contract is entered into (which may be much earlier). In these circumstances, it is not implausible that once the conditions precedent to the completion of the contract (e.g., obtain regulatory or third party consents) providing for the disposal are satisfied, that there is insufficient time to complete the remaining steps in the restructure. Another example is in a takeover scenario which could take greater than 12 months, especially where the compulsory acquisition threshold is not reached with the offer and incremental acquisitions of minority interests are required (e.g., it is not unusual that this could take years). Accordingly, we consider that either the 12 month rule should be extended, or not apply.

- (**Question 10**) We consider that the adoption of a single "push up" cost base rule will not only not deliver simplification benefits, but has the capacity to result in double taxation, as well as limit the likelihood of tax consolidated groups accessing the general business restructure rollover. To elaborate:
    - In a scrip-for-scrip exchange, the acquiring party will generally provide market value consideration for the acquisition in the form of scrip. If the replacement interest inherits the cost base of the original interest, and the original interest's cost base is set by way of a push up, a subsequent sale of the acquired interest at the price actually paid to acquire it, and a distribution of the proceeds arising from the sale has the capacity to result in tax in the hands of both the selling entity, and the holding entity. In other words, there is a material risk of double taxation arising.
    - In addition, where the push up exercise is followed by an immediate push down exercise (i.e., either on the basis that a tax consolidated is formed or the entity joined a tax consolidated group), the subsequent push down would have the capacity to skew cost base away from short-lived assets (such as trading stock, for example) to long-lived assets (such as goodwill, for example), with the consequence of triggering tax on the sale of the trading stock. This can be a material tax cost and can act as a material impediment to restructures. If such an approach is retained (and we submit it should not be), as a minimum the acquiring taxpayer must be provided with the option of sticking with the original cost base of the underlying assets.
    - Finally, there are likely to be material practical difficulties in calculating hybrid tax cost bases where (for example) some shareholders elect for rollover and others do not (either because they choose not to, or because rollover is not available because the interests are held on revenue account, they are a foreign resident and so are ineligible, or the interest is exchanged at a loss). We consider that these practical difficulties will make it a challenge for taxpayers to undertake any hybrid cost base calculations with accuracy.
- (**Question 15**) We consider that partial rollover should be retained. It is common, in takeover situations, for the selling entity to be given an option for cash, scrip, or a combination thereof. This optionality often makes the proposed takeover more attractive, as taxpayers can make decisions that best suit their circumstances. Prohibiting partial rollover has the potential to prohibit mutually advantageous takeover activity.

Finally, we note that there a range of drafting complexities and issues associated with a general business restructure rollover, and there is the possibility of introducing legislation that, through interpretation, results in the availability of rollovers in more limited circumstances (particularly where broad and non-defined terms such as "restructure" are used). Accordingly, although there are benefits in the proposed approach, there are also material risks, including risks that may materialise only over time. We consider that further and detailed consultation will be required in order to ensure that any general business restructure rollover is drafted in an appropriate manner. We look further to assisting the Board on this endeavour.

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

Yours faithfully,

Vivian Chang
Practice Head – Tax
Ashurst

Steve Whittington
Senior Associate
Ashurst

ashurst