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The Board of Taxation Secretariat
The Treasury

Dear Sir/Madam,

REVIEW OF CGT ROLLOVERS CONSULTATION PAPER - BDO SUBMISSION

BDO refer to the invitation by the Board of Tax to provide submissions on the Review of CGT rollovers consultation Paper. BDO is pleased to provide comments in relation many of the consultation paper questions in the attached appendix (see BDO comments in blue type face).

Should you have any questions, or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

BDO National Tax Director

BDO Submission to the Board of Taxation Review of CGT Restructure Rollovers questions

All legislative references below are to the Income Tax Assessment Act 1997 unless otherwise indicated.

1. Do you agree with this articulation of the benefits of a comprehensive, general restructure roll-over? Please provide examples to illustrate these benefits.

BDO can see the benefits of a comprehensive general restructure roll-over, however there are a number of further issues that need to be considered as per the answers to the consultation questions as below.

One issue that is not covered by the consultation questions is the requirement for the acquiring entity to acquire 80% in the target entity under the rollover. The general restructure rollover rules should allow for situations where the acquiring entity already has a less than 80% interest in the target entity before the rollover and then increases their interest to 80% under the rollover. The following wording in the existing scrip for scrip rollover in s124-780(2)(ii) is illustrative of this issue.

*“a company (also an **acquiring entity**) that is a member of such a group increasing the percentage of voting shares that it owns in the original entity, and that company or members of the group becoming the owner of 80% or more of those shares.”*

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

On face value, BDO generally agrees with the benefits of a comprehensive, general business restructure rollover as articulated on page 18 of the consultation paper including providing better clarity and certainty around business restructures, reducing complexity and providing consistency in applying rollover relief to commercial restructuring transactions. However, if the general restructure rollover is to be implemented, careful consideration is needed to determine which rollovers should be combined and replaced and where simplification of rollovers is actually needed. Particularly in respect to certain more complex cases where a general business restructure rollover may have significant implications for both public and private business restructures.

We can see the benefit of having a set of core rollover principles that would cover a number of rollovers. However, just having one set of rules to combine and replace a range of existing vastly different rollovers may be problematic when implemented in practice and could result in unintended tax consequences. For example, consolidating a number of rollovers facilitating demergers, mergers and other business reorganisations and enacting legislation bringing into effect a general restructure rollover will require introducing additional specific rules that need to be tailored to different and more complex rollover scenarios (page 29).

A significant area of concern is that the proposed general business restructure rollover only deals with ownership interests and business assets and does not apply to rollovers of **non-business assets**. The concern is how will the proposed restructure rollover apply to Subdivision 122-A and 122-B which both provide rollover relief for non-business asset? For example, the relevant provisions under Subdivision 122-A and 122-B allow rollovers of non-business assets such as where an individual, trust or a

partnership transfers a land and buildings that are not used in a business to a company. Under the current law, the transfer of the land and buildings will be eligible for rollover relief. However, from the details set out in the consultation paper it would appear that under the business restructure rollover the same transfer of land and buildings to a company will not be eligible for rollover relief.

3. Should the general restructure roll-over be expanded to incorporate the functions of any other existing restructure roll-over? If so, please explain your rationale and provide details (and examples) as to how they can be incorporated.

The general restructure rollover could be expanded to incorporate the functions of the small business CGT rollover under Subdivision 152-E of the ITAA 1997 which was originally designed to provides a rollover for a replacement asset to be used by the small business. However in practice it is mainly used just to defer for two years the making of a capital gain from a CGT event in relation to an asset of the small business. Most subdivision 152-E rollovers do not result in a replacement asset being acquired but rather a CGT gain under CGT events J5 or J6 at the end of the two year replacement asset period. BDO recommends that consideration be given to the small business CGT rollover under Subdivision 152-E being incorporated into the proposed general restructure rollover.

The rationale behind this being that the way taxpayers have been using the small business rollover under Subdivision 152-E is achieving more than its intended purpose.

Consideration could also be given to whether the small business restructure rollovers in Subdivision 328-G could be incorporated into the general restructure rollover. However, we note that this may be difficult to achieve given the significant differences between Subdivision 328-G and the 7 CGT rollovers proposed to be replaced by the general restructure rollover. We also note that the Board of tax has recommend a post implementation review of the small business restructure rollover and this may be the best forum to consider any changes to the small business restructure rollover and whether it could be incorporated into the general restructure rollover.

4. Would the proposed approach outlined in Step 1 to define the relevant ‘business restructure’ provide greater certainty than the current regime? What other alternative approaches should the Board have regard to?

The proposed approach outlined in Step 1 defining the relevant ‘business restructure’, although very broad, will still require businesses to closely scrutinise all the steps or the transactions involved in more than the basic business restructures. Accordingly, this may not create more certainty than the current regime for some rollovers.

It may be necessary to import some of the existing CGT rollover rules if the Board of Taxation wishes to maintain the same level of integrity as under the current CGT restructure rollover provisions. We are able to still see the advantages of the overarching principled rollover framework, but the general business rollover may need to add on specific rules to accommodate more complex cases. The main distinction lies between the scrip for scrip rules under Subdivision 124-M and demergers under Division 125 as compared with the other restructure rollovers proposed to be replaced.

Other alternative approaches which the Board should have regard to, as mentioned in our answer to Question 1, may include introducing additional specific rules that need to be tailored to different and more complex rollover scenarios, as required.

5. Does the features allowing specific CGT events to be excluded from the ‘eligible restructure’ give rise to any integrity concerns or other practical difficulties?

Yes, the features allowing specific CGT events to be excluded from the ‘eligible restructure’ will require consideration of all the steps or the transactions involved in the business restructure to determine which ones should be excluded. As identified at page 20 of the consultation paper, this will impose an additional complexity for some more complex cases.

The exclusion feature may also give rise to integrity issues where consideration is given to how the restructure is designed and which CGT events to exclude based on tax considerations as opposed to genuine commercial considerations. For example to obtain a tax advantage by excluding transactions resulting in a capital loss and/or those transactions that will not qualify for rollover relief i.e. where a CGT event would cause the eligible restructure to fail the eligibility requirements. These types of cases could be dealt with under existing general anti-avoidance provisions but it may be preferable to have specific integrity rules within the general restructure rollover provisions. The reliance on general anti avoidance provisions can create too much uncertainty of the tax outcome of the transactions.

6. Do you have any suggestions relating to the roll-over election rules? Are they practical and could the requirements be further simplified? If so, how?

The consultation paper states that a rollover election is made when the taxpayer lodges its income tax return, however, this will not always be after the 12-month eligible restructure period. Clarification is needed where not all the rollover transactions have been completed at the time of choosing the rollover when lodging the taxpayer’s first tax return after the start of the eligible restructure period. Do all steps in the rollover have to be identified by the time the rollover choice is made? Or can some of the transactions expected to be completed after the lodgement of the tax return remain uncertain until after that date (but before the end of the eligible restructure period). It is not uncommon for some restructure to require changes to the transactions at the last minute for genuine commercial reasons.

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

Generally, limiting the eligible restructure period to 12 months is an appropriate length of time for completion of most common restructures. As mentioned in the Board of Taxation PowerPoint presentation, the eligible restructure period could be 12 months after the CGT event (i.e. ‘the start time’) or when the restructure scheme finishes, whichever is earlier.

If the eligible restructure period was any longer, this may open the restructure up to opportunities to extend its application. It is noted that at page 22 of the consultation paper it suggests that there *“could allow exceptions for a restructure to extend beyond 12 months where there are regulatory requirements, legal disputes or other similar extenuating circumstances which prevent the restructure occurring within 12 months.”* BDO would recommend that this suggestion be adopted and any proposed legislation and accompanying Explanatory Memorandum should provide that the ATO be required to take a reasonable approach when dealing with requests for an extension of the 12 month rule.

9. Where the restructure involves only publicly listed groups, what modifications should be made to further streamline the eligibility conditions? For example, where certain integrity provisions are not relevant or are commercially impractical to apply.

BDO recommends that where restructures involve only publicly listed groups, it would make it easier to make modifications to the business restructure rollover rules as the shareholders of such listed companies are arm’s length shareholders with corresponding legal, Corporations Law and ASX regulations (subject to rules around concentration of ownership as per the definition of ‘public company’ in the Income Tax Legislation)

There is also an argument that such modifications should not be limited to ‘listed groups’ rather they could be extended to all situations where the relevant entities are ‘dealing at arm’s length’.

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

The ‘push up’ cost base rule could cause commercial problems, in scrip for scrip rollovers. Under the current scrip for scrip rule where there are no significant stakeholders or common stakeholder or the arrangement is not a top-hatting restructure, the cost base of the equity interest acquired by the acquiring entity is market value of the original interest it acquires under the rollover. This is the appropriate outcome, as the acquiring entity will be issuing replacement interests to the original entity that would have the same or similar market value. If the cost base of the original interests is based on the cost base of the underlying CGT assets of the target as proposed in the consultation paper, this would create a commercial disincentive for the acquiring entity to enter into the scrip for scrip arrangement.

It is recommended that the push up of the acquiring entity’s cost base of the original interests only be required where the parties to the arrangement are not dealing at arm’s length. All other situations should receive market value cost base.

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

As mentioned in the answer to question 10, the push-up rule may need to have exceptions to ensure there is not a commercial disincentive created by the cost base push-up requirement in some situations.

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

There are concerns around the adoption of a single ‘push-up’ cost base for the acquiring entity. Despite the delivery of simplification advantages, if the ‘push-up’ cost base was preserved, as a consequence of obtaining rollover relief in accordance with the example on pages 35-36 of the paper, the acquirer entity would not be able to get a CGT cost base in the Target shares equal to the market value of the acquirers shares given to target shareholders as consideration. Instead the acquirer would obtain a cost base in the Target shares which is derived from the cost base of the Target’s assets. Following the restructure, this could result in the acquiring shareholders having a cost base with less value than their original ownership interest (i.e. where the underlying value of the Target assets may be less than what the acquiring shareholders paid for their original ownership interests). This result may affect the commercial drivers for the restructure and create a commercial disincentive to proceed with such a restructure arrangement.

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

Yes, BDO agrees with the other proposed consequences for the general rollover including (page 31):

1. **Capital gains and losses disregarded** - where the eligibility conditions are satisfied any capital gains and losses arising from every CGT event elected to form part of the eligible restructure should be disregarded.
2. **Acquisition date** - the proposed deemed acquisition date for the purposes of the CGT discount when the original asset was acquired before the rollover will, as stated in the consultation paper, make it easier for some taxpayers to satisfy the 12 month holding rule. It will also result in an earlier deemed acquisition date in certain circumstances which may require further integrity measures. For example, it may be necessary to provide for exceptions from rollover eligibility for revenue assets or other assets that have not met the 12-month holding requirement, as per the comments on page 31 of the consultation paper (i.e. such assets will not inherit the deemed acquisition date when the original asset was acquired).
3. Cost base (considered in Q10,11,12)

15. Currently, partial roll-over is a feature of Subdivision 124-M and to a limited extent in Subdivisions 122-A and 122-B but not Divisions 125, 615 and Subdivision 126-B.

a. Given that introducing partial roll-over to the general model will increase its complexity, to what extent (if any) should partial roll-over be available under the general model?

b. Please provide examples of transactions which would not occur without partial roll-over?

- a. We see no reason why partial rollover cannot be available for Division 125, Division 615 and Subdivision 126-B type restructures under the general model. However, we note that a partial rollover would be very unlikely in a Division 615 situation and under the current rules if Division 615 is not available for a particular arrangement in most circumstances the arrangement is likely to be eligible for Subdivision 124-M rollover.

16. Paragraphs 1(d) and 5 of the Model Demonstration provides a definition for original and replacement assets. Are there any difficulties with classifying assets into these two categories? Please include examples to illustrate your answer where possible.

It is acknowledged that significant emphasis should not be placed on the exact wording used in the definition of an ‘eligible restructure’ on page 40-41 of the consultation paper except to the extent that it reflects a particular policy setting. However, despite not containing many specific legal requirements, the definition is quite detailed and prescriptive, not dissimilar to many of the CGT rollovers it seeks to replace.

Specifically in relation to Paragraphs 1(d) and 5 of the Model Demonstration, there are some concerns with the definition of original and replacement assets. We note that:

- **an original asset** must be a CGT asset and an ownership interest (e.g. a share in a company) or a business asset but cannot be a non-business asset (e.g. non-business land). Therefore, the transfer of non-business assets under Subdivision 122-A and 122-B will not qualify for rollover relief under the proposed restructure rollovers.
- **a replacement asset** is required to be part of a business restructure. However, clarification is needed as to whether this definition will apply in circumstances where under a scrip rollover, the replacement asset includes shares and cash. From the definition it appears that if there is a disposal of a business asset, the replacement asset can only be a share.

This requirement is also problematic for rollovers under Subdivision 126-B where currently there is no requirement for a replacement asset to be an ownership interest. If the proposed restructure rollover is introduced including the requirement for the replacement asset under subsection 2(b) of the definition, it appears a business restructure under Subdivision 126-B will not qualify for rollover relief under the new rules.

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

We do not see the need to have special rules around capital raisings. If there are value shifting issues these should be dealt with in the general value shifting rules. If it is seen there are specific value shifting issues that are not covered by the general value shifting rules, the general value shifting rules should be amended to deal with the issue.

23. Would you support a general rule that assets received by way of replacement for pre-CGT assets will be taken to be post-CGT assets with a market cost base? Why? Why not?

Yes, BDO would support a general rule that assets received by way of replacement for pre-CGT assets will be taken to be post-CGT assets with a market cost base. The reason being it has been a long time since the introduction of CGT and there would not be very many assets that still have pre-CGT status. Therefore, to reduce complexity it would make sense to adopt this change.

However, to soften this change, BDO would recommend the introduction of transitional provisions to provide taxpayers with pre-CGT assets some time to contemplate the change and consider their circumstances within a relatively short period i.e. 2 years at the most would be sufficient.

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

See answer to question 23

25. Would extending general roll-over to trusts that satisfy CGT event E4 or E10 make relief practically available to AMITs? What additional obstacles, if any, would prevent relief being accessed?

We agree with this proposal.

31. Should the policy surrounding the application of business restructure roll-over relief to arrangements involving consolidatable groups be revisited? On what grounds?

BDO agrees that the policy surrounding the application of business restructure rollover relief to arrangements involving consolidatable groups should be revised. This is on the grounds that, as stated in the consultation paper on page 48, there may be many valid reasons why some wholly owned corporate groups may choose not to consolidate including for small businesses the cost setting process can be a significant barrier to entry. Consolidatable, but non-consolidated groups have not been eligible for rollover relief for transferring assets around the wholly-owned group since the introduction of tax consolidation. This has disadvantaged these groups substantially compared to consolidate groups. We cannot see any reason why business restructure rollover relief should not be available for transfers of assets between member entities of consolidatable groups.

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

Appropriate integrity measures should be revived and implemented where necessary.

33. Would there to be demand from the small business sector to use the general business roll-over given the availability of alternative methods of reducing or eliminating tax liabilities?

The small business sector currently utilise many of the rollovers that are proposed to be replaced by the general restructure rollover and therefore they should be eligible for the proposed general restructure rollover.

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

BDO fully supports the review of the Division 152 and SBRR to ensure they are still providing the intended and appropriate support for small businesses.

In the context of the CGT rollovers we support a review of the small business CGT rollover under Subdivision 152-E and possibly for it to be incorporated into the general business restructure rollover for the reasons outlined in our answer to Question 3 above.

In relation to the SBRR we note that the Board of Tax has already proposed a post implementation review of the SBRR.