The Tax Institute

The Tax Summit

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Session 17.1: CGT roll-overs – Critical Knowledge for advisers

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1. Rollovers

CGT rollovers can be useful tools, particularly where the small business concessions don't apply, and where the structure of the business needs to be updated without necessarily a complete change in economic ownership.

There are many CGT rollovers to choose from, and more than one may potentially be available in a particular situation. In choosing a particular rollover, advisors must consider not only the immediate impacts on the taxpayer but the subsequent impacts of a particular rollover (e.g. cost base, dividend payments, tax consolidation, as well as accounting and legal/regulatory consequences).

1.1 Types of rollovers

The restructure of a business may involve the transfer of CGT assets (original assets) to another entity, usually in return for interests in that new entity (replacement assets). The transfer of a taxpayer's original assets will generally trigger a CGT event. For CGT to not be an impediment to taxpayers restructuring their business, the tax legislation provides a number of rollovers that can reduce or defer a capital gain arising from the disposal of a CGT asset during a restructure.

These rollovers can be broadly classified as "replacement asset rollovers" or "same asset rollovers".

A replacement asset rollover typically allows the taxpayer to defer a capital gain made from the disposal of a CGT asset until a later CGT event happens to that taxpayer.

A same asset rollover generally allows the taxpayer to defer a capital gain made from the disposal of a CGT asset to another entity until a CGT event happens to that other entity.

Each rollover has specific requirements that need to be met and the type of rollover can affect aspects such as:

- the cost base of the original assets or replacement assets;
- the ownership period (for tax purposes) of the replacement asset acquired by a taxpayer;
- the implications on income tax consolidation.

When referring to "rollovers" in this paper, we are not discussing permanent concessions like the general 50% discount, or the small business CGT concessions in Division 152 (apart from the small business rollover).

The following is a list of some of the most commonly used rollovers by SMEs:

Replacement asset rollovers
Small business replacement asset rollover (subdivision 152-E)
Disposal of assets to a wholly-owned company by: • an individual or trust (122-A rollover); or • a partnership (122-B rollover)
"Scrip-for-scrip" rollover (124-M rollover)

Exchange of interests in a fixed trust for shares in a wholly owned company (124-N rollover)
Exchange of shares in one company for shares in an interposed company, or an exchange of units in a unit trust for shares in a company (Div 615 rollover)
Asset compulsorily acquired, lost or destroyed (124-B rollover)

Same asset rollovers
Transfer of CGT asset as a result of marriage breakdown (126-A rollover)
Transfer of CGT assets between related companies (126-B rollover)

Other rollovers
Small business restructure rollover (Subdivision 328-G)

This paper will focus on replacement asset rollovers and certain issues arising. Appendix 1 includes a summary of the impacts various replacement asset rollovers have on cost base and ownership period.

This paper is designed to be read in conjunction with the accompanying presentation, which considers many of these practical issues associated with CGT rollovers.

2. Some things to think about

2.1 Cost base

Depending on the rollover chosen or the particular circumstances of a rollover, a taxpayer may have a different outcome for the tax cost base in their replacement interests. The cost base in the replacement interest could potentially be the original cost base, the 'net assets' or the market value. This is summarised in Appendix 1.

The cost base will then have a flow on impact to calculating any capital gains in the future, but can also have consequential impacts on the structure, such as in the context of tax consolidation.

2.1.1 Impact of CGT rollovers on tax consolidation

The income tax consolidation regime allows a head company and its wholly-owned Australian companies (together with eligible trusts and partnerships) to consolidate for income tax purposes.

Entities that are part of a consolidated group are treated as one entity for income tax purposes and will lodge one income tax return that covers all members of the group. This will allow the losses of one group member to be offset against the assessable income of another entity within the group.

When an income tax consolidated group is formed, or when an entity joins a tax consolidated group, a calculation (termed the Allocable Cost Amount or "ACA" calculation) is undertaken to reset the tax cost bases of assets held by the subsidiary member(s) (also referred to as the "tax cost setting process"). This process is contained in Division 705 of ITAA 1997.

A key to the ACA process is the *cost base* the head company has in the shares of its subsidiary.

Where a head company purchases the shares in a subsidiary at market value, the Step 1 amount would be the market value. Alternatively, where a company owns the shares in a subsidiary for a number of years and then consolidates, even though it may have a nominal cost base for Step 1 purposes, the undistributed frankable profits of the subsidiary that have 'accrued' to the head company may be included in Step 3. Both scenarios might get you to materially the same outcome.

However, the issue with a rollover can be where the holding company newly acquires the interest in the subsidiary and then immediately consolidates. Where the cost base has been inherited from the previous owner under a CGT rollover, the Step 1 amount in an ACA may be nominal if the original shareholder has a nominal cost base. Further, there would be no benefit from the Step 3 amount, as the holding company newly acquired its interests in the subsidiary and therefore has no undistributed frankable profits accrued to it.

Where there is a material difference between the original cost base and the current market value of the subsidiary subject to the rollover, this may cause significant issues on a tax consolidation, depending on the particular mix of assets held by the subsidiary.

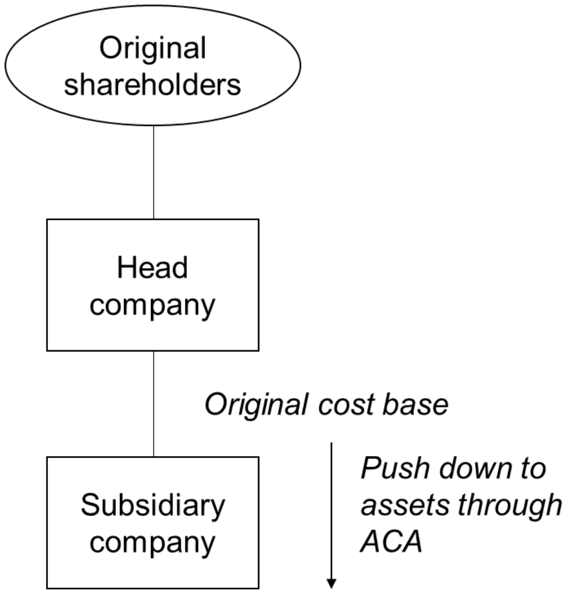
Common issues arise where:

- There is insufficient ACA to cover all the retained cost base assets (like cash, debtors and loans receivable), which gives rise to an L3 gain for the head company; or
- The market value of goodwill is significant compared to the other reset cost base assets, thereby drawing ACA away from assets such as work in progress, inventory, fixed assets, land & buildings. This could have an immediate impact on the taxable position of the consolidated group (through a reduction in depreciation deductions for example).

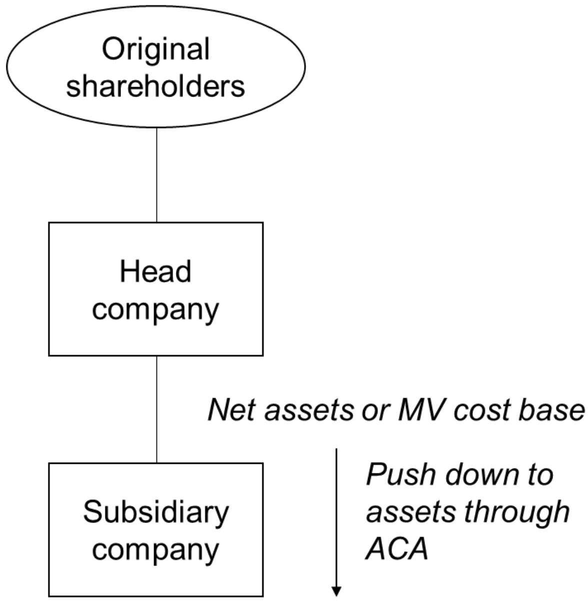
It's important to note that certain rollovers can give you different consolidation consequences depending on the particular circumstances.

The issue is shown simplistically in the diagrams below.

Scenario 1: Original cost base inherited by head company for the cost base in the shares in the subsidiary prior to tax consolidation



Scenario 2: Head company has either net assets or market value cost base for the share sin the subsidiary prior to tax consolidation



2.1.2 Example – merging businesses

Steven owns shares in a company that conducts an online consultancy business. Megan owns shares in a company that conducts a bricks and mortar consultancy business in the same industry. Steven and Megan have decided to come together and access synergies with both businesses working together.

Neither party is eligible for the small business CGT concessions and the turnover of the companies is such that Subdivision 328-G is not available either.

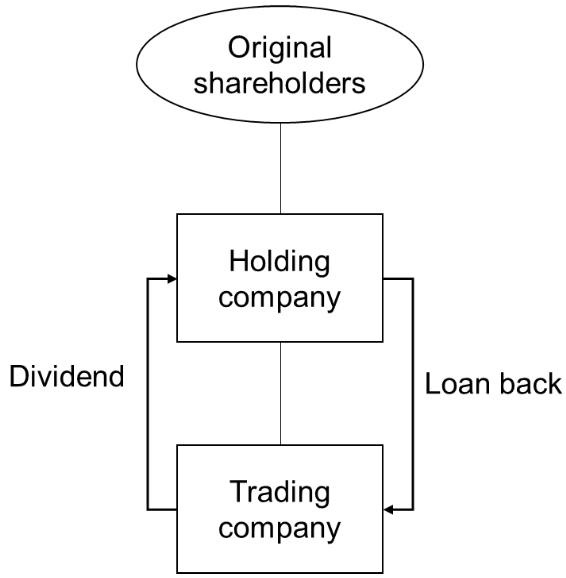
Steven and Megan would prefer the two businesses to come together under one company in order to manage the business with one board of directors. They are open to a corporate structure with a holding company.

Some of the options available to them are as follows:

- **Each company sells their business assets to a newly incorporated company with Steven and Megan as shareholders (in the appropriate proportions).**
  - This option would be the least tax effective on the basis that the capital gain from the sale of any CGT assets would be in the companies and not eligible for the 50% CGT discount.
  - Unless the original companies were to be issued shares in the new company (which is not necessarily a desirable structure going forward), no CGT rollover would be available (and may not be available anyway).
  - Further, existing client, operational and employee contracts would need to be redone for both businesses which is a commercial impediment, and hence the following two options may be more practical.
- **Sale of one company to another through an exchange of shares;**
  - For example, Steven will sell his shares in his company to Megan's company, in exchange for shares in Megan's company.
  - Steven may be eligible for a CGT rollover, likely the rollover in Subdivision 124-M.
  - In this case, Megan's company may inherit Steven's cost base in the shares in Steven's company. This may be a problem if tax consolidation is being contemplated at some point during or after the restructure.
  - If a 'clean' or 'neutral' holding company is desired from a management or capital management point of view, then a further "top hatting" may be required (see below).
- **Sale of both existing companies to a new holding company through an exchange of shares.**
  - A combination of CGT rollovers (e.g. Subdivision 122-A, Division 615, Subdivision 124-M) may be used to disregard any capital gain or loss in the hands of Steven and Megan.
  - Depending on the nature of the CGT rollovers used, it may be possible for the new holding company to achieve more than the original tax cost base in the shares in one of the companies.
  - The appropriate timing and implications of any tax consolidation should be considered.

2.1.3 Example – Top hatting

Nick and his wife own the shares in a trading company, and has done for many years. Nick has been advised by his lawyers that the interposition of a holding company ("top hatting") will enable him to better manage his risk and his capital, and in particular, to manage the accumulating value and retained earnings in the trading company. The desire is to dividend up the retained earnings to the new holding company, and loan back any funds required for working capital. Nick may also set up other subsidiaries under the holding company to hold specific assets or perform specific parts of the business (e.g. employment) as part of his risk management strategy.



Nick's lawyers have approached his tax advisors on how to best achieve this structure. In this example, Nick and his wife are not eligible for the Division 152 concessions or the rollover in Subdivision 328-G. Some tax considerations are as follows:

- Nick and his wife may be eligible for a CGT rollover, potentially Division 615 to sell their shares in the trading company in exchange for shares in the holding company.
- If Division 615 is available in this scenario, then the holding company will likely have a cost base of broadly 'net assets' in the trading company. This may be helpful if the two companies are subsequently tax consolidated.
- Tax consolidation would assist in mitigating any income tax implications on the transfer of any CGT assets to new subsidiaries.
- If not tax consolidating, Nick will need to consider the respective corporate tax rates of the holding company and trading company.

It is worth noting that where top hatting is not an option, and the shareholder is a trust, the dividend and loan back strategy may be available using a corporate beneficiary, however there are other commercial and tax implications and considerations in that scenario (importantly, Division 7A).

2.2 Accounting and documentation implications

2.2.1 How many shares to issue

In implementing a CGT rollover, a key aspect is often how many shares the 'holding company' should issue to the shareholder in consideration for their shares in the 'subsidiary' company.

In implementing a 122-A, if shares are being issued as consideration (noting that in accordance with ATO ID 2004/94, you may not need to issue any consideration), s. 122-20 states:

> *(3) The * market value of the * shares you receive for the trigger event happening must be substantially the same as:*
>
> > *(a) for a disposal case--the market value of the asset or assets you disposed of, less any liabilities the company undertakes to discharge in respect of the asset or assets (as appropriate);*

Whilst the 122-A only requires a 'substantially the same' market value, if implementing a 615 rollover the requirements are different. In particular, s. 615-20 states:

> *(1) Immediately after the completion time, each exchanging member must own:*
>
> > *(a) a whole number of * shares in the interposed company; and*
> >
> > *(b) a percentage of the shares in the interposed company that were issued to all the exchanging members that is equal to the percentage of the shares or units in the original entity that were:*
> >
> > > *(i) owned by the member; and*
> > >
> > > *(ii) disposed of, redeemed or cancelled under the * scheme.*
>
> *(2) The following ratios must be equal:*
>
> > *(a) the ratio of:*
> >
> > > *(i) the * market value of each exchanging member's * shares in the interposed company; to*
> > >
> > > *(ii) the market value of the shares in the interposed company issued to all the exchanging members (worked out immediately after the completion time);*
> >
> > *(b) the ratio of:*
> >
> > > *(i) the market value of that member's shares or units in the original entity that were disposed of, redeemed or cancelled under the * scheme; to*
> > >
> > > *(ii) the market value of all the shares or units in the original entity that were disposed of, redeemed or cancelled under the scheme (worked out immediately before the first disposal, redemption or cancellation).*

Hence, 615 rollovers require a more exact value ratio – the words 'substantially the same' in the 122-A are replaced with 'equal' in a 615 context. 124-M operates a little differently, with s. 124-780 stating:

> *(2) The * arrangement must:*
>
> > *(b) be one in which at least all owners of * voting shares in the original entity (except a company referred to in paragraph (a)) could participate; and*

(c) be one in which participation was available on substantially the same terms for all of the owners of interests of a particular type in the original entity.

……

*(4) The conditions specified in subsection (5) must be satisfied if the original interest holder and an acquiring entity did not deal with each other at * arm's length and:*

*(a) neither the original entity nor the replacement entity had at least 300 * members just before the * arrangement started; or*

*(b) the original interest holder, the original entity and an acquiring entity were all members of the same * linked group just before that time.*

Note: There are some cases where a company will not be regarded as having 300 members: see section 124 - 810.

(5) The conditions are:

*(a) the * market value of the original interest holder's * capital proceeds for the exchange is at least substantially the same as the market value of its original interest; and*

(b) its replacement interest carries the same kind of rights and obligations as those attached to its original interest.

In implementing a 124-M rollover, care should be taken to ensure the “arm’s length” requirement isn’t inadvertently triggered in a problematic way. Notwithstanding this, if only ordinary shares are on issue by all companies, and consideration is market value anyway, the enlivening of ss.(4) and (5) should not be problematic.

2.2.2 Choices

An aspect of rollovers which shouldn’t be forgotten is any choice requirements. While the way in which the relevant tax returns are prepared may be a key starting point, additional choice requirements may also be required.

In a 124-M context, s.124-780(3) states:

*(d) the original interest holder chooses to obtain the roll - over or, if section 124 - 782 applies to it for the * arrangement, it and the replacement entity jointly choose to obtain the roll - over; and*

*(e) if that section applies, the original interest holder informs the replacement entity in writing of the * cost base of its original interest worked out just before a CGT event happened in relation to it;*

In essence, the above provisions require either the original interest holder, or the original interest holder and the interposed entity (if there is a significant or common stakeholder) to choose to access the rollover. The higher burden is placed on the joint-choice, where a need to inform the cost base in writing is required.

For 615 rollovers, s.615-30 places specific requirements on the interposed company regarding the choice, and in particular the timing requirements (which vary depending on whether an existing tax consolidated group is continuing) and the cost base which the interposed entity will have:

(1) Unless subsection (2) applies, the interposed company must choose that section 615 - 65 applies.

*(2) The interposed company must choose that a * consolidated group continues in existence at and after the completion time with the interposed company as its * head company, if:*

> *(a) immediately before the completion time, the consolidated group consisted of the original entity as head company and one or more other members (the other group members); and*
>
> *(b) immediately after the completion time, the interposed company is the head company of a * consolidatable group consisting only of itself and the other group members.*

Note: Sections 703 - 65 to 703 - 80 deal with the effects of the choice for the consolidated group.

(3) A choice under subsection (1) or (2) must be made:

> *(a) within 2 months after the completion time, if the choice is under subsection (1); or*
>
> *(b) within 28 days after the completion time, if the choice is under subsection (2); or*
>
> *(c) within such further time as the Commissioner allows.*

The choice cannot be revoked.

*(4) The way the interposed company prepares its * income tax returns is sufficient evidence of the making of the choice.*

3. The AusNet case

3.1 AusNet Services Limited v Commissioner of Taxation

The case[1] concerned the restructure of a stapled group that was formerly known as AusNet Services. The stapled group consisted of AusNet Services (Transmission) Limited (“Transmission”), AusNet Services Finance Trust (“Finance”) and AusNet Services (Distribution) Limited (“Distribution”). Each unit in Finance was linked (or “stapled”) to a share in Transmission and a share in Distribution such that none could be transferred or otherwise dealt with without the others. Together, these stapled securities had been listed on the Australian and Singapore stock exchanges.

For Australian income tax purposes, each of Transmission and Distribution was a head company of a separate tax consolidated group (“TCG”) formed pursuant to Part 3-90 of the *Income Tax Assessment Act 1997* (Cth) (“ITAA97”) (the Transmission TCG and Distribution TCG respectively).

Pursuant to a series of schemes of arrangement, on 18 June 2015, the applicant, AusNet Services Ltd, acquired all of the shares in Transmission, all the units in Finance and all the shares in Distribution. The former holders of the stapled securities became shareholders of the applicant. Thereafter, Distribution became a subsidiary member of a TCG, with the applicant as the head company.

3.1.1 Issue

The applicant objected to income tax assessments issued to it in respect of years of income ended 31 March 2016 to 31 March 2020 in lieu of the years ended 30 June 2016 to 30 June 2020 (“the relevant income years”).

The issue for determination concerned the construction of the roll-over provisions in Division 615 of the ITAA97. The outcome of the case determined whether the applicant was entitled to an uplift in the cost bases of the assets formerly held by the Distribution TCG. An uplift in those cost bases would have the effect of, amongst other things, increasing the capital allowance deductions that could be claimed by the applicant.

The applicant contended that Division 615 roll-over did <u>not</u> apply to the scheme of arrangement, and, although it had originally submitted a Division 615 roll-over election, this election could not have been valid because the requirements of Division 615 were not met. Therefore, the applicant contended that it should be entitled to an increase in the cost bases of the assets of the former Distribution TCG. Conversely, the Commissioner took the position that a valid roll-over election for Division 615 roll-over had been made and therefore the applicant was not entitled to an increase in those cost bases.

By the time of hearing, the parties agreed that the resolution of the following two questions concerning the application of Division 615 will be dispositive of the matters in issue between them:

1. Was there a scheme for reorganising the affairs of Distribution for the purposes of paragraph 615-5(1)(c)?
2. Were the ratios in subsection 615-20(2) equal?

3.1.2 Facts of the case

On 19 October 2005, Distribution, Transmission and AusNet Services Ltd as trustee of Finance (together, the “SPI Group”), entered into a stapling deed. In summary, the terms of the deed stipulated that, *inter alia*:

[1] AusNet Services Limited v Commissioner of Taxation [2024] FCA 90

- the shares or units in the SPI group could not be transferred unless the securities to which they were stapled were also transferred to the same transferee;
- any entity could not issue a security unless each of the other entities issued a corresponding security at the same time to the same person;
- each stapled security be listed and subject of a joint certificate; and
- that each entity must agree with others in relation to restructuring or reorganising the capital of any of them.

The effect of the stapling arrangements was that, as a matter of commerce, the stapled entities were to be managed as though they were a single entity.

The officers / directors of the stapled group decided it would be in the interests of security holders to "interpose" a single holding company between the security holders and each of the stapled entities so that rather than security holders holding three securities stapled to each other, each security holder became a shareholder in the new holding company.

The applicant had been incorporated on 11 December 2014, as a shelf company, with two ordinary fully paid $1 shares issued to a wholly-owned subsidiary of Distribution.

On 14 April 2015, Transmission, Distribution, AusNet Services Ltd as trustee of Finance and the applicant entered into an Implementation Deed under which they agreed to undertake a restructure, which would take place in the following order:

1. The shares / units would be "unstapled".
2. Shares / units held by certain foreign security holders were to be transferred to a nominee for a sale facility who was to sell the shares in the applicant it would come to hold after the implementation of the restructure and distribute the sale proceeds to those foreign security holders.
3. The applicant was to acquire all the Transmission shares for consideration in the form of shares in the applicant. At the same time, the applicant was to cancel the two shares held by the subsidiary of Distribution, under a selective capital reduction.
4. The applicant was to make an election that the Transmission TCG was to continue in existence with the applicant as the new head company of the TCG.
5. The applicant was to acquire all the Finance units for consideration in the form of shares in the applicant.
6. The applicant was to acquire all the Distribution shares for consideration in the form of shares in the applicant.
7. By resolution of the applicant's shareholders, all the shares in the applicant were to be converted to that number of shares equal to the number of stapled securities that had been on issue at the record date.

On 18 June 2015, the above steps occurred in the order noted.

On 18 June 2015, the applicant's public officer signed a document titled "*AusNet Services Ltd – choice under subsection 615-30(1) of the Income Tax Assessment Act 1997*" which stated that the applicant "*hereby chooses to apply section 615-65 of that Act in respect of the acquisition*" by the applicant of Finance and Distribution respectively.

On 1 July 2015, the Commissioner issued Class Ruling CR 2015/45 in which it ruled that the conditions for roll-over under Div 615 were satisfied in relation to the disposal of each Transmission share, Distribution share and Finance unit to the applicant and, therefore, security holders were eligible to choose roll-over under Division 615 in respect of their disposal of Transmission shares, Distribution shares and Finance units to the applicant.

In respect of each of the relevant income years, the applicant lodged income tax returns prepared on the basis that Division 615 applied in connection with the acquisition of its shares in Distribution, contrary to what the applicant described as its longstanding position.

By notices of objection lodged on 13 October 2020 and 21 April 2021, the applicant objected to the assessments issued to it in respect of the relevant income years, on the basis that (relevantly) section 615-65 did not apply, with the consequence that the cost base of the applicant's shares in Distribution was $2.025bn.

The Commissioner disallowed the objections, rejecting the applicant's construction of s 615-65.

3.1.3 Applicant's contentions

The applicant contended that s 615-65 does not apply to it in respect of its shares in Distribution for two reasons:

1. The conditions in paragraph 615-5(1)(c) were not satisfied because there was no scheme for reorganising Distribution's affairs as required by the terms of the section; and
2. The ratio calculated under paragraph 615-20(2)(a) in relation to the Distribution scheme did not equal the ratio calculated under paragraph 615-20(2)(b). As a result, it was contended that the requirements in Subdivision 615-B were not met and therefore paragraph 615-5(1)(d) could not be satisfied.

Paragraph 615-5(1)(c) requires that under a "scheme for reorganising its affairs," the Distribution shareholders disposed of all their Distribution shares to the applicant in exchange for shares in the applicant and "nothing else".

The applicant contended that for paragraph 615-5(1)(c) to be satisfied, it would need to be concluded that the Distribution scheme was undertaken for reorganising *its* affairs and not for reorganising Distribution's affairs *and the affairs of another entity*.

It was contended that following the Distribution scheme, substantially the same business was not being carried on by Distribution. The scheme was not simply an internal arrangement because, by the time of the Distribution scheme, the applicant was a company with a market value of $3.4bn and the effect of the scheme was to expand the business being carried on from just being Distribution's business to that of both the applicant and Distribution. What occurred under the Distribution scheme is more accurately described as an amalgamation or a merger.

It was contended that at the time of the Distribution scheme, the applicant was a substantial entity with a market value of $3.4bn and Distribution had a market value of $2.025bn. The result of the scheme was that the affairs of both entities were "reorganised".

It was contended that a reorganisation that results in some change in the business of the entity, or under which there is an alteration to the percentage ownership interests in the entity, is not one that is eligible for roll-over relief under Division 615.

These two disqualifying consequences were said to be present here. First, it was submitted that carried forward tax losses of the Distribution TCG were cancelled as a result of the scheme because the same business test could not be satisfied. Second, it was submitted a reorganisation can satisfy paragraph 615-5(1)(c) only if the reorganisation is confined to the existing ownership group and does not work any alteration to the percentage interest of the existing ownership group. On the applicant's submission that section 615-20 was not satisfied, it followed that the Distribution scheme could not satisfy the description of a scheme for reorganising in paragraph 615-5(1)(c). It was said that because section 615-20 was not satisfied, there had been an alteration to the percentage ownership interests in Distribution (when calculated by reference to value).

Second, it was further contended that the Distribution scheme did not satisfy the "and nothing else" requirement as required by the concluding words of paragraph 615-5(1)(c). It was submitted that, as a result of the "features of the applicant by the time of the Distribution Scheme, the shareholders entering into the Distribution Scheme received shares in an entity (the applicant) carrying on businesses that Distribution did not previously carry on".

The shareholders of Distribution became shareholders in a company with substantial franking credits with the ability to immediately pay franked distributions (unlike Distribution). The applicant submitted that an examination of the ratios in section 615-20 discloses that mathematically it could be demonstrated that the Distribution shareholder received not only shares in the applicant but also "something else" in the form of an uplift in value in the shares each of them held in the applicant as a result of the Transmission and Finance schemes.

The crux of the applicant's submissions was that the requirements of paragraph 615-5(1)(c) and section 615-20 could not be satisfied in relation to Distribution because of the characteristics of the applicant as the interposed company at the time of the Distribution scheme. The applicant's submission was that Division 615 was premised on a roll-over involving a valuable or substantial original entity and the interposition of a company of nominal value, colloquially referred to as a "shelf company". It was submitted that, in essence, here there had been a merger or amalgamation or reorganisation of two valuable entities because at the time of the Distribution scheme, the interposed company was not a shelf company. Instead, because the applicant had at that moment already acquired the Transmission and Finance businesses, it was a company with a substantial market value. The applicant submitted that because Division 615 was not intended to apply in circumstances where the interposed company was not a shelf company, it was not surprising in the applicant's submission, that the ratios in section 615-20 were not equal. The requirement that the interposed company be a shelf company was said to be consistent with the views expressed by the Commissioner in Taxation Ruling TR 97/18.

3.1.4 Analysis

The Federal Court noted that applicant's contentions are premised on at least two related assumptions:

1. That, at the "completion time", the market value of the applicant was substantial and equal to the value of Transmission and Finance.
2. That the reorganisation of Distribution not only occurred after the reorganisation of Transmission and Finance, but that value was transferred to the applicant in the same sequence so that at the time the Distribution scheme took place, the market value of the shares in the applicant was reflective only of the value of Transmission and Finance.

The Court held that, at a factual level, the applicant's contention that the scheme in the present case was not a scheme for reorganising Distribution's affairs (because the scheme had the effect of not only reorganising Distribution's affairs but also the affairs of the new interposed entity) overlooks the fact that prior to the restructure, Distribution did not operate a separate stand-alone business.

Distribution's business had been intertwined with the businesses of Transmission and Finance. Distribution was required to co-operate with Finance and Transmission in respect of all matters concerning the stapled securities including accounting and valuation policies. The board members of Distribution were the same as the board members of the trustee of Finance and Transmission. The directors and officers of Distribution were required to carry out their duties with a view to enhancing the market value of the group as a whole and have regard to the interests of the security holders as a whole rather than only to the interests of Distribution shareholders considered separately.

The Court further highlighted that, as a matter of economic substance, from the time the stapling arrangements were put in place, the business of the Distribution group had been managed and operated as though it were part of a single economic entity that included Transmission and Finance. The fact that tax losses were cancelled does not support a conclusion that the scheme resulted in a change in Distribution's business.

The applicant's submission was premised on the factual assumption that the shares issued in the applicant immediately prior to the completion of the Distribution scheme had a market value equal to the agreed market value of Transmission and Finance. That factual assumption was not accepted by the Court.

Immediately after the Finance exchange, it was effectively certain that the Distribution exchange would occur. In those circumstances, it was determined that it would be artificial to value the shares in the applicant issued on the first two exchanges without having regard to the third exchange. And it would be artificial to regard the Distribution exchange, when it did occur later that same day, as giving rise to something "else" which the exchanging members received in exchange for their shares in Distribution.

The applicant's case rested on the proposition that Division 615 roll-over could not be applied if there is "any value that is brought in that is not attributable to the exchange". The disentitling element in the present case was said to arise by reason of the so-called sequential acquisition of Transmission, Finance and then Distribution. For the reasons explained above, the sequencing did not have the effect contended for by the applicant.

In summary, The Federal Court held that the Division 615 roll-over rules applied and therefore the shares did not qualify for a step up in base cost under the alternative scrip-for-scrip roll-over in Subdivision 124-M. This was because although the Distribution shares were "unstapled" from the shares of two other entities prior to their acquisition, these shares did not have independent value from their interests in the previously stapled entities.

3.1.5 Full Federal Court decision

AusNet's appeal to the Full Federal Court[2] was dismissed. The Full Court upheld the primary judge's findings that:

- The scheme did constitute a reorganisation of Distribution's affairs.
- The 'nothing else' requirement was met.
- The ratio equality requirement in s 615-20(2) was satisfied.

On the 'scheme for reorganising affairs':

- The Court accepted that the scheme restructured the ownership structure of Distribution, aligning it with its economic reality.
- The statutory language was found to support this interpretation.

Logan J stated at 28 that the:

> *"…qualifying description does indeed narrow the focus of 'affairs' in the way the primary judge concluded."*

On the 'nothing else' requirement, The Court held that 'nothing else' refers strictly to the contractual consideration for the share exchange - not incidental market benefits or indirect consequences.

Logan J stated at 46:

> *"The focus of this provision is just on the consideration for the exchange... not incidental consequences."*

On ratio equality (s 615-20(2)), The Court affirmed the primary judge's view that all shares held at completion should be considered.

[2] AusNet Services Limited v FCT [2025] FCAFC 21

The taxpayer noted the following, which Logan J agreed with at paragraph 48:

> *"The ratios test whether the relative value of shareholdings both before and after the reorganisation… are exactly equal."*

3.1.6 High Court

The High Court[3] recently refused AusNet's special leave application, noting in paragraph 2 of its decision:

> *"The proposed appeal does not have sufficient prospects of success to warrant a grant of special leave. Nor does it raise any question of law of general application or public importance."*

3.1.7 Difficulties of roll-overs

Strictly speaking, this case dealt with very unique (and arguably niche) issues surrounding stapled securities and their un-stapling just prior to a broader reorganisation. However, at a broader level, it does present a number of factors that advisors should always take into consideration in the intricate differences between different roll-overs and the how different the relevant tax consequences of applying different roll-overs can be.

Some of the specific difficulties to note include:

- **Requirement to make a choice:** To apply for a roll-over under Division 615, the new entity is required to make a choice under section 615-30 within certain timeframes, being either 2 months or 28 days after the completion time. The section states that it is also sufficient to make the election in the tax return of the interposed entity. This ambiguity can often cause confusion and it is clear that the tax return of the interposed entity may not be lodged with 2 month or 28 days of the roll-over.

- **Lack of flexibility:** Where the conditions for Division 615 have been satisfied, a taxpayer must choose relief under Division 615 (if at all) and there is no choice to avail of relief under Subdivision 124-M (scrip-for-scrip roll-over) even though the overall tax consequences under the latter may be better to the interposed company (but the same tax consequences to the shareholders). As can be seen in this case this can sometimes deny a taxpayer their preferred relief.

- **"Nothing else":** Although this condition was deemed to have been satisfied on this occasion, this point can often be contentious as a taxpayer needs to ensure that they only receive shares in the interposed entity for the roll-over to apply. In practice, on occasion, this condition can cause denial of the roll-over relief.

[3] AusNet Services Ltd v Commissioner of Taxation [2025] HCADisp 166

4. Some areas of ATO interest

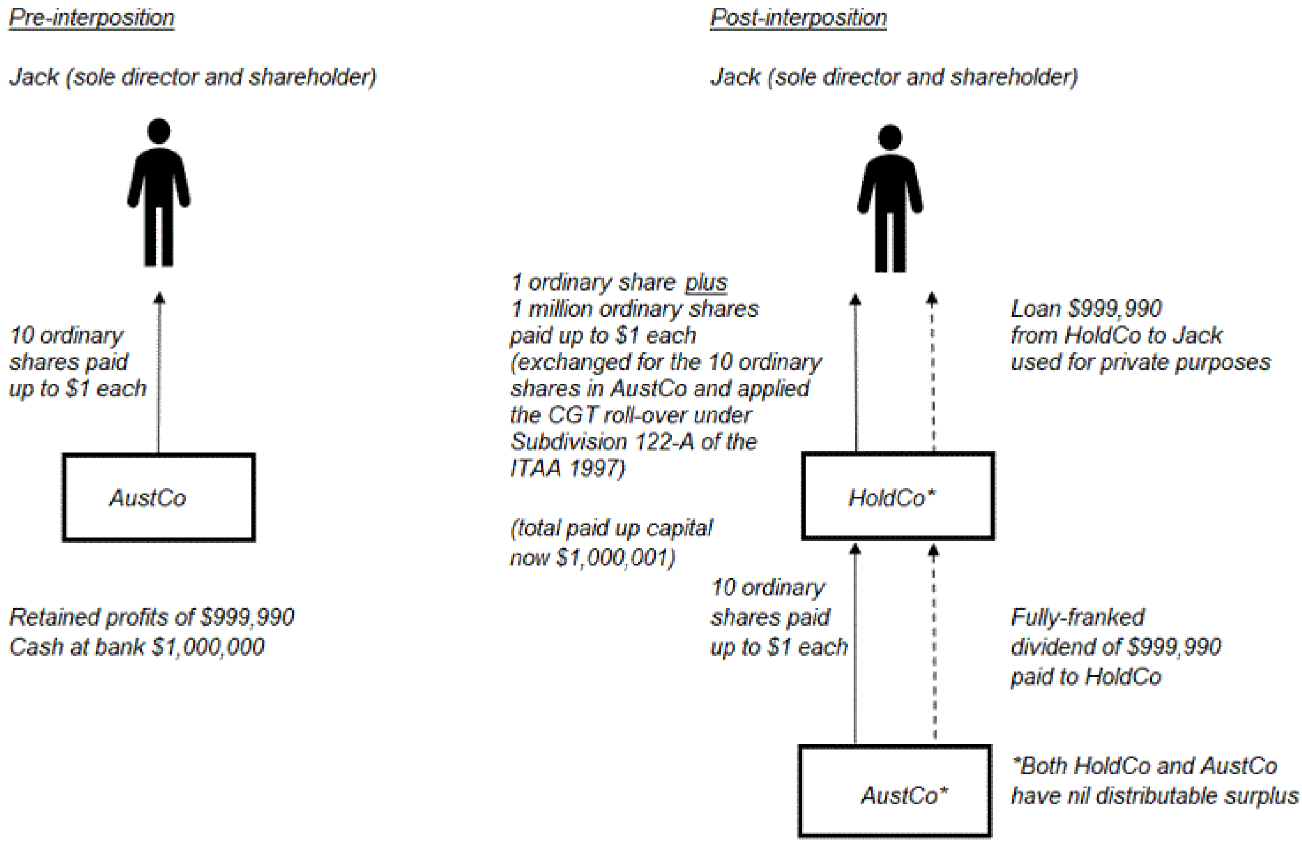
4.1 TA 2023/1 - Interposition of a holding company to access company profits tax-free

Whilst the specific steps within a CGT rollover are not the core target of TA 2023/1, the use of a CGT rollover is an integral part of the scenario that Taxpayer Alert TA 2023/1 covers. A description of the typical arrangement the TA covers is as follows:

> *6. These arrangements typically display all or most of the following features:*
>
> *•A private company (first company) has retained profits on which it may have paid tax at the corporate rate. Shares in the first company are held by an individual who may also be a director of the first company.*
>
> *•The individual disposes of their shares in the first company to a private company (interposed company), receiving shares in the interposed company in return.*
>
> *•The shares in the interposed company are issued at a paid-up amount being the same as, or similar to, the net assets of the first company which includes the retained profits of the first company.*
>
> *•The individual applies a CGT roll-over, such as the CGT roll-over in Subdivision 122-A of the ITAA 1997, to disregard for tax purposes any capital gain on the disposal of those shares in the first company.*
>
> *•The first company declares a franked dividend to the interposed company.*
>
> *•The first company discharges its liability to pay the dividend by ways such as cash, cheque or promissory note.*
>
> *•The interposed company provides a loan to the individual, sourced from the dividend received. The terms of the loan do not comply with section 109N.[4] For example, the loan may be interest-free and repayable at call.*
>
> *•Neither the interposed company nor the first company have sufficient distributable surplus[5] for Division 7A to treat the loan made to the individual as a deemed dividend (whether directly from the interposed company or indirectly from the first company).*
>
> *•Viewed objectively, the arrangements have the dominant purpose of tax avoidance.*

To assist in understanding the types of concerns more fully, the TA includes an example, which is set out below:

> *7. The following example illustrates the broader features of these arrangements. Our concern is not limited to the specific scenario described but, rather, can apply to variations of that scenario with its main features. Variations include where shares in the first company are pre-CGT shares or a holding company is interposed between a trustee shareholder and a company.*
>
> ***Diagram: Interposition of a holding company to access company profits***



8. *Jack is the sole shareholder and director of AustCo Pty Ltd (AustCo), an Australian private company. As at 31 May 2020, he has 10 ordinary shares in AustCo fully paid up to $1 each. AustCo has cash at bank of $1 million, consisting of the $10 paid-up share capital and accumulated profits of $999,990 from prior year trust distributions. AustCo has no other assets. Jack wants to access the retained profits for private purposes.*

9. *On 4 June 2020, Jack incorporates a company, HoldCo Pty Ltd (HoldCo), for which he is the sole director and shareholder, holding one ordinary share fully paid up to $1.*

10. *On 15 June 2020, Jack transfers his 10 ordinary shares in AustCo (valued at $1 million) to HoldCo and, in return, HoldCo issues Jack a million ordinary shares fully paid up to $1 each. Both Jack and HoldCo adopt the amount of $1 million as being the consideration for the transaction.*

11. *Jack makes a choice for roll-over relief under Subdivision 122-A of the ITAA 1997. Accordingly, the capital gain made by Jack from the disposal of his AustCo shares to HoldCo is disregarded.*

12. *On 29 June 2020, AustCo declares and pays a fully franked dividend of $999,990 to HoldCo, as its only shareholder.*

13. *On 30 June 2020, HoldCo lends $999,990 to Jack on terms which are unsecured, interest-free and repayable at call.*

14. *The accounting records for both HoldCo and AustCo show nil distributable surplus as at 30 June 2020.*[6] *Therefore, Division 7A does not operate to treat Jack as having received a dividend in the 2019-20 income year.*

15. *AustCo is then wound up. The loan remains uncalled and outstanding.*

> 16. *Putting to one side the taxation outcomes, AustCo could have provided its accumulated profits to Jack by far simpler means, such as by paying him a dividend or providing him with an interest-free, unsecured loan (which would also be assessable as a deemed dividend under Division 7A).*[7]
>
> 17. *Viewed objectively, the arrangements appear to have the dominant purpose of avoiding tax.*

As noted above, the core concerns of the ATO are not the use of a CGT rollover of itself, but rather the position that rollover may put a taxpayer in to then endeavour to access funds without otherwise triggering adverse Division 7A consequences. The TA notes:

> *18. We are concerned that individual taxpayers and private companies under their control may be entering into these arrangements under the misapprehension that they are effective in avoiding additional tax being paid by the individual taxpayer. We will closely examine these arrangements, including those where a holding company is interposed between a trustee shareholder and a company as similar concerns apply.*
>
> *19. More specifically, aspects of the arrangement that concern us include whether:*
>
> *•there is any intention for the purported 'loan' to the individual to be repaid or whether the amount may be taken to be an assessable dividend paid to the individual pursuant to section 109C of Division 7A*[8]
>
> *•the arrangements comprise a 'dividend stripping' scheme or operation, such that*
>
> > *-section 177E applies to include the amount of the purported loan in the taxpayer's assessable income, and*
> >
> > *-section 207-145 of the ITAA 1997 applies to cancel the franking credit on the dividend paid to the interposed company, or*
>
> *•this is a scheme under section 177D to which the general anti-avoidance provisions in Part IVA apply.*

4.1.1 What happens if you didn't loan the amounts out?

While the Commissioner's concerns in the TA appear reasonable where there is a clear intent of the taxpayer to circumvent the operation of Division 7A, what happens if there is no Division 7A mischief. For example, assume the scenario noted above, but instead of loaning funds from HoldCo to Jack, an actual distribution was proposed? Under the Corporations Act, it may be possible to pay a dividend from HoldCo, but if it is out of share capital of HoldCo then the tax laws would not allow for such dividend to be franked.

Instead of paying a dividend, could a return of capital be made to the shareholder? Instead of receiving a dividend, the shareholder instead may have a capital gain in their hands (which may be discountable if the relevant criteria are met). Is there any Part IVA risk?

In implementing a CGT rollover, the ability to extract funds from the structure in the future should be considered, and if funds are required in the short term, should a dividend be paid prior to a restructure taking place? Would that cause any other issues?

4.2 Back-to-back CGT rollovers

It is not uncommon for a restructure to involve multiple rollovers to move from the initial structure to the desired position. While this will typically be for sound commercial reasons, the Commissioner has long held concerns that in some instances the implementation of back-to-back CGT rollovers could drift into anti-avoidance territory.

For many years, the Commissioner has proposed to issue guidance on back-to-back rollovers, with the AusNet case having recently delayed the issue of such guidance. With that case now concluded, the Commissioner has noted that the issue of a draft PCG is slated for late 2025. It is hoped that such guidance provides useful boundaries for taxpayers to legitimately implement back-to-back rollovers without the fear of being at high risk of the Commissioner viewing it as being subject to Part IVA.

An extract from the ATO website on 29 August 2025 with the status of the back-to-back CGT rollovers guidance is set out below:

[3953] Back-to-back CGT rollovers

Title

Draft Practical Compliance Guideline

Back-to-back CGT roll-overs – ATO compliance approach

Purpose

This draft Guideline will explain when we are more likely to apply compliance resources to consider potential tax risks, including the application of Part IVA of the *Income Tax Assessment Act 1936* (the general anti-avoidance provisions of the income tax law) to an arrangement that comprises multiple CGT rollovers.

Expected completion

Late 2025

Comments

Estimated completion in late 2025 is subject to the High Court's finalisation of the appeal of the Full Federal Court's decision in *AusNet Services Limited v Commissioner of Taxation* [2025] FCAFC 21.

5. Others CGT rollover aspects

5.1 Why is the impact of a roll-over on an ownership period important?

The impact a roll-over has on the ownership period of a replacement asset acquired by a taxpayer could affect whether the taxpayer is eligible for the 50% CGT general discount upon disposal of the replacement asset.

As indicated in the in the Appendix, when a taxpayer applies one or more replacement asset roll-overs, other than a 122-A roll-over, a 122-B roll-over or 124-N roll-over (an “eligible replacement asset roll-over”), the taxpayer is deemed to have acquired the replacement asset received under the latest roll-over at the same time the taxpayer acquired the first CGT asset that was the subject of the roll-over.

Thus, if a taxpayer owned their original CGT asset for more than 12 months prior to applying the roll-over, the taxpayer should be eligible to apply the general discount to any capital gain arising upon disposal of the replacement asset (if they are an individual or trust that may qualify for such a restructure).

On the other hand, if a taxpayer applies a 122-A, 122-B or a 124-N roll-over, they are not automatically deemed to have held their replacement interests from the date they acquired their original interests. This means that the general CGT discount will not automatically apply to the disposal of the replacement interests, even if the taxpayer had owned the original interests for more than 12 months.

Rather, if the taxpayer wishes to dispose their replacement interests within 12 months of the date of the roll-over and apply the 50% discount to a resulting capital gain, the taxpayer must meet the following additional requirements:

- the company’s “new CGT assets” must not exceed 50% of the total value of the company by cost base or by unrealised capital gains at the time of the disposal; and
- the combined period that the taxpayer has owned their originals interests and replacement interests must exceed 12 months.

If these requirements are not met, the taxpayer’s ownership period for the purposes of the 50% discount effectively “resets” from the date the replacement interest is acquired and so the taxpayer would need to own the replacement interests for at least 12 months from this date in order to be eligible for the discount.

The 50% CGT discount is likely to be of less relevance to a company which is looking to dispose of its assets, as companies are not eligible to apply the 50% CGT general discount.

5.2 Which roll-over should a taxpayer use?

A taxpayer may sometimes have a choice between two or more CGT roll-overs, or between a roll-over and another CGT concession (e.g. the small business CGT concessions). In this instance, taxpayers may often apply the roll-over with the simplest eligibility requirements. However, these choices are often short-sighted and do not consider the impact of the roll-over with other areas of tax.

In making a decision as to which CGT roll-over to apply, if any, taxpayers should consider their future plans for the asset being transferred, the tax implications of these plans and the impact of the various roll-overs on the cost base of a replacement asset. For example:

- if an individual recently acquired a significant business asset with a substantial value and is planning to transfer their business to a company and sell the shares in that company to a buyer within 12 months, the 122-A roll-over may not be the best option for the individual. The recent acquisition of a significant asset may mean that the individual is not able to access the 50% CGT general discount upon the sale of their shares in the company as the cost base of the "new assets" of the company may be more than 50% of the total cost base of all the assets in the company; or

- if an individual has pre-CGT units in a unit trust, a 124-N (transfer by trust to wholly owned company) roll-over may be favoured over a 124-M (scrip-for-scrip) roll-over. A 124-N roll-over would allow the individual to treat the replacement shares as pre-CGT assets, whereas replacement shares acquired under a 124-M roll-over will not be treated as pre-CGT assets.
- The accounting journal entries are worth considering in any restructure scenario. This could have implications for future distributions of profit (and whether they would be frankable), among other things.

Other implications such as GST, stamp duties and legal ramifications or documentation required should also be considered at the outset.

Even if a taxpayer has no choice but to use a particular CGT roll-over, awareness of any potential future tax implications allows the taxpayer to plan for an adverse tax liability (e.g. by waiting an additional 12 months before selling the replacement asset).

6. Appendix 1 - Summary of some commonly used CGT roll-overs

Roll-over	Description of roll-over	Impact on cost base of replacement asset	Impact on cost base of acquiring entity	Impact on ownership period
Small business replacement asset roll-over (**Subdivision 152-E**)	Taxpayer that is eligible for the small business CGT concessions can defer a capital gain from disposal of a CGT asset for at least 2 years & potentially much longer if an eligible replacement asset is acquired.	No impact on cost base of replacement asset. However, the rolled over amount is a separate gain which has been deferred	Not applicable	No change to acquisition date of replacement asset. 50% general CGT discount cannot be applied a second time to the original (deferred) capital gain.
Disposal of assets to a wholly-owned company by: • an individual or trust (**122-A roll-over**); or • a partnership (**122-B roll-over**)	Can be applied to certain assets transferred by the individual or trust. Capital gain from disposal of the asset(s) is disregarded. Pre-CGT status of original assets is retained.	Cost base of the shares in the wholly-owned company broadly deemed to be the cost base of taxpayer's original assets.	Acquiring entity's cost base in the original assets broadly deemed to be taxpayer's cost base in original assets.	Original interest holder is deemed to have held the shares for more than 12 months, if, at the time of a CGT event the: • cost base of "new assets" < 50% of cost base of all company assets; and • unrealised capital gains on "new assets" < 50% of unrealised capital gains on all company assets. "New assets" are those assets owned by the company and/or the original interest holder for less than 12 months (original assets taken to have original acquisition date)

Roll-over	Description of roll-over	Impact on cost base of replacement asset	Impact on cost base of acquiring entity	Impact on ownership period
“Scrip-for-scrip” roll-over (**124-M roll-over**)	Typically used where one company/unit trust (acquiring entity) acquires 80% or more of the shares/units in a second company/unit trust (target entity) and the original interest holders of the target entity exchange their original interests for replacement interests in the acquiring entity. Capital gain from disposal of the shares/units is disregarded. Roll-over not available if taxpayer can apply 122-A roll-over or Div 615 roll-over. Roll-over not available to foreign residents, unless the replacement interest is taxable Australian property. Pre-CGT status of original interests is not retained. Possible to have partial roll-over.	For post-CGT interests, cost base of replacement interest is deemed to be the cost base of the original interest. For pre-CGT interests, cost base of replacement interest is deemed to be its market value just after it was acquired.	Cost base of original interests acquired by acquiring entity is target entity’s original cost base where significant or common stakeholder. Significant stakeholder where an entity and its associates have shares carrying 30% or more of voting, dividend or capital rights in original entity and acquiring entity. Common stakeholder where an entity or 2 or more entities and their associates between them had 80% or more of the voting, dividend or capital rights in original entity and acquiring entity. Where no significant or common stakeholder, acquiring entity’s cost base in original interest is market value.	Replacement interest is deemed to be acquired at the same time the taxpayer acquired their original interest. If there is an “unbroken series” of replacement asset roll-overs (other than 122-A, 122-B and 124-N roll-overs), the final replacement interest is deemed to be acquired at the same time the taxpayer acquired their original interest under the first roll-over.

Roll-over	Description of roll-over	Impact on cost base of replacement asset	Impact on cost base of acquiring entity	Impact on ownership period
Exchange of interests in a fixed trust for shares in a wholly owned company (**124-N roll-over**)	Available if one or more fixed trusts dispose all their CGT assets to a wholly-owned company and the interests in the trust(s) are replaced with shares in the company. Roll-over relief is available to the transferring trust(s) as well as the interest holders of the original trusts. Pre-CGT assets status of original interest holders is retained (for shares and for underlying CGT assets).	Cost base of the shares is deemed to be the cost base of the original interests in the trust.	Wholly owned company's cost base in original assets deemed to be trust's cost base in those assets.	Shareholder taxpayers are deemed to have held the shares for more than 12 months if the same conditions that apply to 122-A and 122-B roll-overs are met (see above).

Roll-over	Description of roll-over	Impact on cost base of replacement asset	Impact on cost base of acquiring entity	Impact on ownership period
Exchange of shares in one company for shares in an interposed company, or an exchange of units in a unit trust for shares in a company (**Div 615 roll-over**)	Available if a new company (interposed entity) is interposed between the original shareholders of a second company (original company) and the original company, or between the original unit holders of a unit trust (original trust) and the original trust. All the shares in the original company or units in the original unit trust must end up being owned by the interposed entity. Capital gain from disposal of the shares/units is disregarded. Roll-over not available if there is only one original interest holder. Pre-CGT status of original interests is retained.	Cost base of the shares in the interposed entity is deemed to be the cost base of the original interests acquired.	If assets acquired post-CGT, cost base of interposed entity's shares in acquired entity is cost base at completion time of original entity's assets less certain liabilities.	Replacement interest is deemed to be acquired at the same time the taxpayer acquired their original interest. If there is an "unbroken series" of replacement roll-overs (other than 122-A, 122-B or 124-N roll-overs), the final replacement interest is deemed to be acquired at the same time as the taxpayer acquired their original interest under the first roll-over.