The Tax Institute

Local Tax Club- Melbourne/Geelong

Session 10: Small Business Restructuring

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1. Considering whether to transfer a business from trust to company

The Commissioner's views regarding the Div 7A consequences of declaring UPEs in favour of a family company, combined with his renewed attention to existing provisions in Div 6 such as 100A and s 99B have significantly curtailed the benefits of carrying on a business in a discretionary trust and using a 'bucket company' to effectively retain access to trust income while capping tax on that income at the corporate rate. It is for this reason that, in some circumstances where a discretionary combined with a 'bucket company' may have previously been the business structure of choice, a company may now be equally, if not more effective.

In such circumstances consideration may be given to whether it is appropriate to transfer an existing business from a discretionary trust to a private company. The following issues are relevant to this decision making process:

- the CGT consequences of transferring business assets;
- the income tax consequences of transferring trading stock;
- the balancing adjustment consequences of transferring depreciating assets; and

Other issues to consider include GST, state duty payable on business transfers, and any administrative consequences of restructuring (such as transferring employees, customer agreements, equipment leases, third party financing arrangements etc.).

This paper will consider the following 'pathways' to a tax effective restructuring from trust to company:

- Div 152 – Small business CGT concessions
- Subdiv 328-G – Small business restructure roll-over
- Subdiv 122-A – Disposal or creation of assets by an individual or trustee to a wholly-owned company
- Subdiv 124-N – Disposal of assets by a (unit) trust to a company

2. Small business CGT concessions (Div 152)

Division 152 of the ITAA 1997 contains CGT concessions that are available to entities that are, in broad terms, considered small businesses. These concessions enable a capital gain that arises from a CGT event to be disregarded, reduced or deferred under the small business CGT concessions provided that certain conditions are satisfied.

The four available small business CGT concessions are:

- the 15-year exemption (Subdivision 152-B);
- the small business 50 percent reduction (Subdivision 152-C);
- the retirement exemption (Subdivision 152-D); and
- the small business roll-over (Subdivision 152-E).

The basic conditions contained in Subdivision 152-A must be satisfied in order for any of these concessions to be available. The taxpayer may also need to satisfy additional requirements to qualify for a specific concession.

The basic conditions are as follows:

- A CGT event must happen in relation to an asset the taxpayer owns.
- The event would otherwise have resulted in a capital gain.
- At least one of the following applies:
  - the taxpayer is a **CGT small business entity** for the income year;
  - the taxpayer satisfies the **maximum net asset value test**;
  - the taxpayer is a partner in a partnership that is a CGT small business entity and the asset is an interest in an asset of the partnership; or
  - (broadly) the CGT asset concerned is used in the business of a connected entity of affiliate of the taxpayer that is a CGT small business entity.
- The CGT asset satisfies the **active asset** test.

If the asset is a share in a company or an interest in a trust, a number of additional conditions must be satisfied.

2.1 Summary of concessions

Concession	Description	Ref.
15 year exemption	An individual is entitled to a full exemption if: • the basic conditions are satisfied	Subdiv 152-B

<table>
<tr><th>Concession</th><th>Description</th><th>Ref.</th></tr>
<tr><td></td><td>the asset has been owned continuously for over 15 years
if the CGT asset is a share in a company or an interest in a trust, the company or trust must have had a <u>significant individual</u> for a total of 15 years during which it owned the CGT asset
the taxpayer is at least 55 years of age and the CGT event happens in connection with the retirement of the taxpayer, or the taxpayer is permanently incapacitated at the time of the event
A company or trust is entitled to a full exemption if:
the <u>basic conditions</u> are satisfied
the asset has been held continuously for over 15 years
the taxpayer had a <u>significant individual</u> for a total of 15 years during the period of ownership
a <u>significant individual</u> just before the CGT event is at least 55 years of age and the CGT event happens in connection with the retirement of the taxpayer, or the taxpayer is permanently incapacitated at the time of the event</td><td></td></tr>
<tr><td>Small business 50% reduction</td><td>If the <u>basic conditions</u> are satisfied the taxpayer is able to reduce the capital gain on <u>active assets</u> by 50%.

It is not compulsory to apply the small business 50% reduction</td><td>Subdiv 152-C</td></tr>
<tr><td>Retirement exemption</td><td>An individual taxpayer may disregard a capital gain if:
the <u>basic conditions</u> are satisfied
if the taxpayer is under 55, the proceeds from the event are rolled over into a complying superannuation fund
A company or trust may disregard a capital gain if:
the <u>basic conditions</u> are satisfied
the taxpayer has a <u>significant individual</u> just before the CGT event
a payment is made to a <u>CGT concession stakeholder</u>
if the recipient of the payment is under 55 the payment must be made to the <u>CGT concession stakeholder</u> by contributing it to a complying superannuation fund
There is a lifetime limit of $500,000 on the amount which can be treated as exempt for any one individual.</td><td>Subdiv 152-D</td></tr>
</table>

Concession	Description	Ref.
Small business roll-over	If the basic conditions are satisfied, a taxpayer may roll-over a capital gain against the acquisition of a replacement business asset. The capital gain is crystallised when the replacement asset ceases to be held as an active asset.	Subdiv 152-E

2.2 Transfer of a business from trust to company - Roll-over or sale to which Div 152 is applied?

When a decision has been made to transfer a business from discretionary trust to private company, consideration should be given to whether the business assets should be rolled-over (such that CGT relief is available under Subdiv 122-A, further discussed below) or sold to the private company (thereby triggering a capital gain which may be able to be reduced or eliminated by the small business CGT concessions in Div 152).

Consideration	Comment
Is the business pre-CGT?	If the business is pre-CGT the same asset roll-over provided by Subdiv 122-A will ensure that the business assets retain their pre-CGT assets in the hands of the company.
Are the following basic conditions for small business CGT relief satisfied: • the trust is a small business entity or it passes the $6 million net asset test? • the CGT assets are active assets?	If the trust does not satisfy the basic conditions for the small business CGT concessions, then roll-over relief under Subdiv 122-A should be considered.
Can the small business 15 year exemption be accessed by the trust? • Have the relevant assets been owned by the trust for at least 15 years? • Has the trust had a significant individual for at least 15 years during which it owned the asset? • Is a significant individual of the trust 55 or over and retiring (or permanently incapacitated)?	If the trust can access the small business 15 year exemption the capital gain will be permanently disregarded in its entirety.

Consideration	Comment
Can the small business retirement exemption be accessed by the trust? • Does the trust satisfy the significant individual test (i.e. does an individual have a 20% ‘interest’ in the trust just before the CGT event)? • If all CGT concession stakeholders in the trust are under 55 years old, does the trust have access to sufficient cash to contribute capital proceeds to superannuation?	If the trust can access the small business retirement exemption its capital gain will be permanently disregarded (up to a lifetime limit of $500,000 for each CGT concession stakeholder in the trust).
Are there external circumstances which may render the structuring requirements of Subdiv 122-A (in particular the requirement that the company be wholly-owned by the trust) inappropriate or unacceptable (e.g. industry regulations require the company to be completely or partially owned by individual shareholders)?	Roll-over relief under Subdiv 122-A will not be available where the requirements are not satisfied. It follows that a sale from the trust to the private company (to which Div 152 is applied) provides significantly greater flexibility in terms of the shareholding in the private company.
Does the restructure involve a transfer of depreciating assets?	Balancing adjustment roll-over relief for transfer of depreciating assets will be available only if the trust is able to choose CGT roll-over relief under Subdiv 122-A. It follows that the structuring requirements of Subdiv 122-A (e.g. the requirement that the company be wholly-owned by the trust) must be satisfied in order to obtain balancing adjustment roll-over relief. **Note:** There is no requirement that roll-over relief under Subdiv 122-A actually be chosen.

3. Small business restructure roll-over

From 1 July 2016 small businesses have been provided with a new roll-over for gains and losses arising from the transfer of CGT assets, trading stock, revenue assets and depreciating assets as part of a restructure of a small business.

3.1.1 How it works?

Subdiv 328-G will provide an **optional roll-over** where a **small business entity** transfers an **active asset** of the business **to another small business entity** as part of **a genuine business restructure**, without changing the **ultimate economic ownership** of the asset.

The tax cost/s of the transferred asset or assets is rolled over from the entity that transferred the asset or assets (the transferor) to the entity to which the asset or assets are transferred (the transferee). This is achieved by providing that, for the purposes of applying the income tax law:

- the transferor is taken to have received an amount which approximates the 'tax cost' of the asset to them (that is, the amount the income tax law recognises as the transferor's cost); and
- the transferee is taken to have acquired each asset for the amount that equals the transferor's tax cost for the asset just before the transfer.1

3.1.2 What you need to know?

- The roll-over is available for asset transfers taking place on or after 1 July 2016.
- The roll-over can apply to CGT assets, depreciating assets, trading stock and/or revenue assets.
- The roll-over is optional and can be applied on an asset by asset basis.
- Transfer of the asset must be, or must be a part of, a genuine restructure of an ongoing business (discussed further below).
- Each party to the roll-over must be a small business entity (or affiliated with a SBE, connected with a SBE or a partnership in a partnership that is a SBE) for the year in which the transfer occurred.
- Ultimate economic ownership in the asset must be maintained (also discussed further below).
- The roll-over will not apply to a transfer to or from an exempt entity or complying superannuation entity.
- To ensure that the asset transfer does not trigger any other income tax consequences, such as a deemed dividend under Div 7A, a 'tax neutral' rule has been introduced which 'switches off' the application of existing income tax law. However, any FBT, GST and/or stamp duty consequences of the transfer will remain – the new rules do not provide any relief against a tax liability in those areas.

[1] The amount of any actual consideration provided is not taken into account.

- For the purpose of determining eligibility for the 15 year CGT exemption for small businesses, the transferee will be taken as having acquired the asset when the transferor acquired it i.e. the transferor's ownership period will be counted towards the 15 years.

- By contrast, for CGT discount purposes, the 12 month time period for CGT will re-start on transfer – the transferor's ownership period will NOT be counted. This is to avoid the roll-over being used to transfer assets from a non-discount eligible entity (usually a company) to an entity that is entitled to the discount shortly before sale of the asset. Keep in mind however, that the roll-over can be used to access the discount for a gain that effectively accrued to a company by transferring the business to a discount-eligible entity at least 12 months prior to sale (provided it can be shown that the transfer is part of a genuine restructure or the safe harbour can be used).

- Roll-over relief is available for depreciating asset pools.

Genuine restructure

To be eligible for the roll-over the transfer of the asset must be, or must be a part of, a genuine restructure of an ongoing business (a requirement that did not exist in the Exposure Draft legislation).

In the words of the Explanatory Memorandum, whether a restructure is 'genuine' is a question of fact that is determined having regard to all of the facts and circumstances surrounding the restructure.

Examples listed in the Explanatory Memorandum of factors that would indicate a genuine restructure include:

- it is a bona fide commercial arrangement undertaken to enhance business efficiency;

- the business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership;

- the transferred assets continue to be used in the business;

- the restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business;

- the restructure is not artificial or unduly tax driven; and

- it is not a divestment or preliminary step to facilitate the economic realisation of assets.

Refer to LCG 2016/D3 which discusses the features that, in the Commissioner's view, indicate that a restructure falls within the scope of genuine restructure, and those features that indicate that the restructure falls outside.

Safe harbour

Presumably due to the nebulous nature of the requirement that the transfer be a 'genuine restructure', a safe harbour rule is included to provide certainty to taxpayers.

A small business will be taken to satisfy the requirement that the transaction is, or is a part of, a 'genuine restructure' of an ongoing business where, for three years following the roll-over:

a. there is no change in the ultimate economic ownership of any of the significant assets of the business (other than trading stock) that were transferred under the transaction;

- those significant assets continue to be active assets; and
- there is no significant or material use of those significant assets for private purposes.

What qualifies as a 'significant asset' for these purposes is a question of fact according to Example 9 in LCR 2016/3.

If a small business does not meet the requirements of the safe harbour, it can still access the roll-over by satisfying the general principle that the transaction is, or is a part of, a genuine restructure of an ongoing business.

Ultimate economic ownership

To be eligible for the roll-over the transaction must not have the effect of changing the ultimate economic ownership of transferred assets (i.e. the individuals who, directly or indirectly, beneficially own the asset) in a material way. Points to note include:

- If there is more than one individual who is an ultimate economic owner of an asset, the same proportionate ownership in the asset must be maintained.
- An 'immaterial' change in economic ownership appears to be permissible – the Explanatory Memorandum does not elaborate on what constitutes immaterial.
- Where a discretionary trust is involved in the roll-over (either as transferor or transferee) there is a savings provision (whereby the ultimate economic ownership requirement is taken to be satisfied) if, in broad terms, the trust has a family trust election in place and every individual who had ultimate economic ownership of the transferred asset before the transfer, and every individual who has ultimate economic ownership of the transferred asset after the transfer, are members of the family group relating to the family trust.

4. Subdiv 122-A – Disposal or creation of assets by an individual or trustee to a wholly-owned company

Subdiv 122-A provides optional roll-over relief where:

- an asset, or all the assets of a business, are transferred by an individual or a trustee to a wholly-owned company; or
- certain rights are created by an individual or a trustee in a wholly-owned company.

4.1 Overview

Subdiv 122-A provides a combination of replacement asset and same asset CGT roll-over relief when an individual or trust transfers an asset or assets to a wholly-owned company, as follows:

Replacement asset roll-over – the individual or trust replaces the transferred asset with shares in the company. Any capital gain or loss triggered by the transfer is disregarded. The cost base of the replacement shares in the hands of the individual or trust is taken to be equal to the cost base of the transferred asset or assets.

Same asset roll-over – the cost base of the transferred asset or assets in the hands of the wholly-owned transferee company is taken to be the cost base of the asset in the hands of the individual or trust.

4.2 Requirements to be satisfied

Subdiv 122-A sets out the requirements that must be satisfied to obtain roll-over relief where assets are transferred to, or created in, a wholly-owned company.

4.2.1 Relevant CGT events

An individual or a trustee can choose to obtain roll-over relief only in respect of the following CGT events:

- CGT event A1 – disposing of a CGT asset, or all the assets of a business2, to the company;
- CGT event D1 – creating contractual or other rights in the company;
- CGT event D2 – granting an option to the company;
- CGT event D3 – granting the company a right to income from mining; and

[2] An asset used partly in a business and partly for other purposes (e.g. a commercial building part of which is used as a retail outlet for the taxpayer's business and the rest is rented out by the taxpayer to two other unrelated businesses) is an asset of the business for the purpose of the roll-over (ATO ID 2005/218).

- CGT event F1 – granting a lease to the company, or renew or extend a lease.

4.2.2 Consideration received for the CGT event

For roll-over relief to be available, any consideration received by the taxpayer for the CGT event happening must be only:

- non-redeemable shares in the company; or
- where there's a disposal – non-redeemable shares in the company and the company undertaking to discharge one or more liabilities in respect of the asset or assets of the business.

(Sections 122-20(1) and (2))

In the Commissioner's view there is no requirement that consideration be actually received by the transferor entity i.e there is no requirement that shares in the transferee company be issued or transferred to the transferor provided that the transferor own all the shares in the company just after the CGT event (ATO ID 2004/94).

It follows that roll-over relief will be available where the transferor disposes of an asset to a company in which they own all of the issued shares and are not issued with any new shares or paid any other form of consideration by the company. Where this happens the special rules for determining the cost base of the transferor's shares in the transferee company (outlined below) will not apply.

4.2.3 Receiving shares as consideration

Shares received as consideration for the CGT event happening (either by way of issue or transfer[3]) must satisfy the following requirements:

- the shares must be non-redeemable; and
- their market value must be substantially the same as the following:

Circumstances	Market value of shares issued
Disposal	Market value of shares issued must be substantially the same as the market value of the asset or assets disposed of, less any liabilities assumed by the company in respect of the asset or assets (s 122-20(3)(a)). Where market value is different to what it would otherwise be only because of contingent liabilities attaching to the asset or assets, the difference is ignored (s 122-20(4)).
Creation	Market value of shares issued must be substantially the same as the market value of the CGT asset created (s 122-20(3)(b)).

[3] ATO ID 2004/95 (withdrawn)

4.2.4 Assumption of liabilities

Roll-over relief will be available, where a company undertakes to discharge a liability in respect of an asset, only if the liability satisfies the following conditions:

- the liability must be in respect of transferred assets;[4]
- the amount of the liability must not exceed the maximum amount outlined in the following table (s 122-35(1)(b)):

Type of roll-over	Nature of asset	Liability cannot exceed
Trust disposes of a CGT asset to company	Post-CGT asset	Asset's cost base
	Pre-CGT asset	Asset's market value
Trust disposes of all the assets of a business to company	All assets are post-CGT	Sum of: • market value of trading stock • market value of depreciating assets • cost base of other assets
	All assets are pre-CGT	Sum of market value of all assets
	Some assets are post-CGT and some are pre-CGT	For liabilities in respect of post-CGT assets, sum of: • market value of trading stock • market value of depreciating assets • cost base of other assets For liabilities in respect of pre-CGT assets, sum of market value of all assets

In order to determine whether a particular liability satisfies these requirements it may be necessary to determine which assets that liability is in respect of (if any). The following rules in s 122-37 must be used in order to do this:

- a liability incurred for the purposes of a business that is not a liability in respect of a specific asset or assets is taken to be a liability in respect of all assets (e.g. a bank overdraft); and

[4] The requirement that shares received as consideration for the transfer of assets have a market value which takes into account only liabilities in respect of the asset or assets transferred, effectively means that roll-over will not be available if the transferee company assumes any liabilities which **do not** relate to the asset or assets transferred.

- if a liability is in respect of two or more assets, it is taken to be in respect of each asset in proportion to their market value.

4.2.5 Shareholding in transferee company

The taxpayer must own all the shares in the transferee company just after the CGT event (s 122-25(1)). The following points should be noted in this regard:

- Where the transferor is a trust with joint trustees, all the shares in the transferee company must be jointly owned by the trustees (ATO ID 2004/8).
- No roll-over is available where the asset to be rolled-over is jointly owned by two or more people. That is because the requirement that all shares in the company are owned by the transferor cannot be satisfied. This is so notwithstanding that the shares acquired in exchange for the asset rolled-over may be held in the same proportions as the taxpayers held interests in the asset (ATO ID 2002/172 (withdrawn)).[5]

Shares in the transferee company must be owned by the taxpayer in the same capacity as it owned the transferred assets just before the transfer (s 122-25(1)). For example, if the taxpayer was a trustee who owned the transferred assets on trust, the shares must also be held on trust (presumably the *same* trust)[6]

Roll-over relief will not be available where the ordinary and statutory income of the company is tax-exempt for the income year of the CGT event (s 122-25(5)).

4.2.6 Precluded assets

Roll-over relief is not available for the following types of assets:

- collectables;
- personal use assets;
- decorations awarded for valour or brave conduct; and
- assets that become trading stock or a registered emissions unit of the company just after the disposal or the creation of the asset (unless the asset was the taxpayer's trading stock or registered emissions unit at the time of disposal).

(Section 122-25(2))

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[5] Roll-over may be available if each owner rolled over their interest to a separate company in which they owned all of the shares.

[6] Section 160ZZN(4)(c) (the 1936 Act equivalent of subdiv 122-A) requires that the shares be held on the **same** trust. The Explanatory Memorandum to *Taxation Laws Improvement Act (No. 1) 1998* (which introduced Subdiv 122-A) suggests that the rewritten provision does not explicitly refer to a requirement that the shares be held on the same trust because a different trust would be a different entity in accordance with the definition of 'entity' in s 960-100, so that roll-over relief would not be available in any event.

4.2.7 Residency requirements

For roll-over relief to be available, the individual or trustee and the company must be residents at the time of the CGT event (s 122-25(6)(a) and (7)(a)). Special rules apply where the individual, trust or company is a non-resident for tax purposes (s 122-25(6)(b) and (7)(b)).

4.2.8 Making a choice to use the roll-over

The choice must be made by the day the taxpayer lodges the tax return for the income year in which the CGT event to which roll-over relief is to apply happened, or within such further time as the Commissioner allows (s 103-25(1)).

The choice to use roll-over relief is evidenced by the way in which the income tax return of the taxpayer is prepared (s 103-25(2)).

4.3 Consequences of applying 122-A roll-over

There are consequences for both the individual or trustee and the company in applying the 122-A roll-over.

4.3.1 Consequences for individual or trustee

If a taxpayer chooses to take advantage of roll-over relief in relation to the disposal or creation of an asset, any capital gain or loss the taxpayer makes from the disposal or creation is disregarded (s 122-40(1), 122-45(1), 122-65(1)).

The roll-over is a replacement asset roll-over because the asset being disposed of or created is being replaced by shares in the company. In this context, roll-over relief effectively operates to defer the tax which would otherwise be payable on the disposal or creation of an asset, to the disposal of the shares in the company (the shares being the replacement assets).

The cost base (and reduced cost) of each share received as consideration for the disposal or creation will depend on whether the assets being rolled-over are:

- pre-CGT assets;
- post-CGT assets; or
- a combination of pre-CGT assets and post CGT assets.

Note that where the transferor disposes of an asset to a company in which they own all of the issued shares and are not issued with any new shares or paid any other form of consideration by the company, the special rules for determining the cost base of the transferor’s shares in the transferee company (outlined below) will not apply (ATO ID 2004/94).

Cost base of shares if all assets are pre-CGT assets

Where all the assets that are being rolled-over are pre-CGT assets, the shares in the company are also taken to be pre-CGT assets (s 122-55).

An exception to this rule is where any of the assets being disposed of are depreciating assets or trading stock (s 122-55(2)). In that case, the percentage of shares that are taken to be pre-CGT assets is as follows:

$$\frac{\text{Market value of assets excl. depreciating assets and trading stock} - \text{liabilities assumed}}{\text{Market value of all assets} - \text{liabilities assumed}}$$

(Section 122-55(2))

The remaining shares that are not pre-CGT assets are taken to be post CGT-asset. The cost base (and reduced cost) of each of those post-CGT shares is calculated as follows:

$$\frac{\text{Market value of depreciating assets and trading stock} - \text{liabilities assumed}}{\text{Number of post-CGT shares}}$$

(Section 122-55(3))

Cost base of shares if all assets are post-CGT assets

Where all assets being rolled-over are post-CGT assets, the first element of the cost base (and reduced cost base) of each share received by the taxpayer is calculated as follows:

Circumstances	Cost base (reduced cost base) of each share
Disposal	$\frac{\text{Asset's cost base or reduced cost base} - \text{Amount of liabilities assumed}}{\text{Number of shares}}$ (Sections 122-40(2), 122-50(1)) NOTE: If the assets of the business being rolled-over include depreciating assets and/or trading stock, the cost base of each share must also include the market value of such assets (s 122-50(1)(a)).
Creation	$\frac{\text{Expenditure incurred in creating the right}}{\text{Number of shares}}$ (Section 122-65(2))

4.3.2 Cost base of shares if assets are a combination of pre-CGT assets and post-CGT assets

The number of shares that are taken to be pre-CGT assets will be limited where the business assets that are being rolled-over are a combination of pre-CGT assets and post-CGT assets (s 122-60).

In those circumstances, the percentage of shares that are taken to be pre-CGT assets is calculated as follows:

$$\frac{\text{Market value of pre-CGT assets excl. depreciating assets and trading stock} - \text{liabilities assumed}}{\text{Market value of all assets} - \text{liabilities assumed}}$$

(Section 122-60(1)

The remaining shares that are not pre-CGT assets are taken to be post-CGT assets. The cost base (and reduced cost) of each of those post-CGT shares is calculated as follows:

$$\frac{\text{Market value of depreciating assets and trading stock} + \text{cost base or reduced cost base of post-CGT assets} - \text{liabilities assumed}}{\text{Number of post-CGT shares}}$$

(Section 122-60(2))

4.4 Consequences for the company acquiring the asset

Where a taxpayer chooses to take advantage of roll-over relief in relation to the disposal or creation of assets in a wholly-owned company, there are CGT consequences for the company acquiring those assets (ss 122-70, 122-75).

The cost base (or reduced cost base) of the acquired asset in the hands of the company is determined as follows:

Circumstances	Cost base (or reduced cost base) of asset
Asset disposed of by the individual or trustee	Post-CGT asset – asset’s cost base (or reduced cost base) at the time of the disposal (s 122-70(2)). Pre-CGT asset – capital gain or loss is disregarded (s 122-70(3), Div 104)).
Asset created by the individual or trustee	Expenditure incurred by the individual or trustee in creating the asset

5. Disposal of assets by a trust to a company – Subdiv 124-N

Subdiv 124-N is relevant to the 'conversion' of a trust to a company. Such a 'conversion' involves:

- the transfer of assets from the trust to the company; and
- the exchange of beneficiaries' interest in the trust for shares in the company.

Subdiv 124-N may provide optional roll-over relief in these circumstances, provided that the 'conversion' is completed within six months.

5.1 Requirements for roll-over

Roll-over relief may be chosen under Subdiv 124-N if all of the following conditions are satisfied:

- one or more trusts7 dispose of all their CGT assets to a company (s 124-855(1)(a)) - an exception to this rule is that the trust may retain assets to pay existing or expected debts (s 124-860(1)).
- CGT event E4 is capable of applying to all of the interests in the trust (s 124-855(1)(c)) - it follows that the 'conversion' of a discretionary trust to a company cannot benefit from this roll-over (because CGT event E4 cannot apply to a discretionary trust).
- the company must satisfy the following conditions (unless it is the trustee of the trust, in which case only the first condition must be satisfied):
  - it must not be exempt from income tax (s 124-860(3));
  - it must never have carried on commercial activities (s 124-860(4)(a));
  - it must have no amounts of CGT assets other than small amounts of cash or debt (s 124-860(4)(b)); and
  - it must have no losses of any kind (s 124-860(4)(c));
- just after the 'conversion' is complete, i.e. the last trust asset is disposed of to the company, the shareholders must own shares in the company in the same proportions, and of the substantially the same market value, as they owned interests in the trust (s 124-860(6));[8]

Query whether the market value condition in s 124-860(6) will be satisfied if the market value of assets changes during the period of restructure. Given that the period of restructure may extend as long as six months this seems quite conceivable due to trading fluctuations and for other reasons. Unfortunately, to the author's knowledge, there is no further guidance as to what 'substantially the same' means.

- the company must be an Australian resident (s 124-860(8)).

[7] If more than one trust is involved each interest holder must own an equal proportion of interests in each trust (s 124-855(2)).

[8] This condition is satisfied notwithstanding that up to five shares in the company may have been owned before the restructure provided that the market value of those shares is such that it is reasonable to ignore them (s 124-860(7)).

- the assets transferred from the trust to the company cannot become trading stock of the company (s 124-875(5)).
- Roll-over relief is available for the company and trust only if **both** entities choose it (s 124-865). The owners of interests in the entities must choose independently for roll-over relief to apply to them (s 124-870).

Roll-over relief is not available for owner of interests in the trust if either of the following conditions are satisfied:

- the interest holder is not an Australian resident **and** the shares in the company do not have the necessary connection with Australia (s 124-870(3)); or
- the replacement shares become trading stock of the interest holder when they are acquired (s 124-870(5)).

5.2 Consequences of roll-over

There are consequences of choosing roll-over relief under Subdiv 124-N for the following entities:

- owners of interests in the trust;
- the trust itself; and
- the company.

5.2.1 Consequences for owners of interests in the trust

The consequences for owners of interests in the trust of choosing roll-over relief under Subdiv 124-N are as follows:

- a capital gain or loss made from disposal of the trust interests is disregarded (s 124-15(2));
- if all the trust interests were post-CGT the first element of the shares' cost base (or reduced cost base) is the total of the cost bases (or reduced cost bases) of all the trust interests, divided by the number of shares (s 124-15(3));
- if the trust interests were all pre-CGT the shares will also be pre-CGT (s 124-15(4));
- if only some of the trust interests were pre-CGT the same proportion of shares will also be treated as pre-CGT (s 124-15(5)), and the cost bases (and reduced cost bases) of the remaining shares (i.e. the post-CGT shares) will be equal to the total of the cost bases (or reduced cost bases) of original post-CGT trust interests divided by the number of post-CGT shares or units (s 124-15(6)).

CGT event J4

A capital gain or capital loss will be crystallized for the interest holder under CGT event J4 if the trust is not wound up within six months of the first asset being transferred to the company (or as soon as practicable thereafter if it cannot be wound up within six months because of circumstances outside the control of the trustee). Essentially, the interest holder will make a capital gain or loss equal to the difference between the market value of the share when the interest holder acquires it and the cost base of the share at that time (s 104-195(6)). The share holder's cost base in the shares for the purposes of any future CGT events will be equal to the market value of the shares at the time the shareholder acquired them (s 104-195(7)).

5.2.2 Consequences for the transferor trust

Any capital gain or loss the trustee makes from disposing of its assets to the company will be disregarded (s 124-875).

5.2.3 Consequences for the transferee company

The consequences of for the transferee company of choosing roll-over relief under Subdiv 124-N can be summarised as follows:

- the company will inherit the trust's cost base (or reduced cost base) in all of the assets (s 124-875(2)); and
- any pre-CGT assets of the trust will remain pre-CGT assets in the hands of the company (s 124-875(3)).

CGT event J4

A capital gain or capital loss will be crystallized for the company under CGT event J4 if the trust is not wound up within six months of the first asset being transferred to the company (or as soon as practicable thereafter if it cannot be wound up within six months because of circumstances outside the control of the trustee). Essentially, the company will make a capital gain or loss equal to the difference between the market value of the asset when the company acquires it and the cost base of the asset at that time (s 104-195(4)). The company's cost base in the asset for the purposes of any future CGT events will be equal to the market value of the asset at the time the company acquired it (s 104-195(5)).

6. Other issues

6.1 Transfer of trading stock

The transfer of trading stock to a wholly-owned company does not attract any roll-over relief, other than small business restructure roll-over relief under Subdiv 328-G. The transfer will be treated as a disposal of trading stock outside the ordinary course of business such that the assessable income of the transferor includes the market value of the stock on the date of the transfer (s 70-90).

This outcome may be able to be addressed in a number of ways:

- arguing that the market value of the stock in the context of a business transfer is the wholesale price and therefore not much different to book value;
- avail oneself of the election available in s 70-100 to treat the stock as disposed of at closing value via a 'double shuffle';
- decline to transfer the trading stock, but rather have the company sell it on consignment for the trust.

6.2 Roll-over of depreciating assets

Balancing adjustment roll-over relief applies automatically in circumstances where CGT roll-over relief for transfers to a wholly-owned company is available.

Balancing adjustment roll-over relief has the following consequences:

- any balancing adjustment that would otherwise be included in the transferor's assessable income or be an allowable deduction is disregarded (s 40-345(1)); and
- the wholly-owned company can claim deductions for the asset's decline in value as if there had been no change in ownership. In doing so, the transferee company can deduct the decline in value of the asset using:
  - the same method that the transferor was using; and
  - the same effective life (or remaining effective life9 if the relevant method is the prime cost method) that the transferor was using.

(Section 40-34xzx5(2))

The first element of cost of the depreciating asset for the transferee company is the adjustable value of the asset just before the balancing adjustment event occurred (s 40-180(2) Item 6).

[9] 'Remaining effective life' for these purposes is any period of an asset's effective life which is yet to elapse as at the tim e of the balancing adjustment event (s 40-75(4)(b)).

6.3 Is a business valuation required?

Getting a valuation for a business that is to be restructured from trust to company in a non-arm's length context may be required in the following circumstances:

- To determine whether the taxpayer satisfies the $6 million maximum net asset value test for the purposes of accessing the small business CGT concessions.
- Trading stock is being transferred and some relief other than Subdiv 328-G is being used to shelter the capital gain and/or depreciating asset balancing adjustment amount.
- Depreciating assets are being transferred and the small business CGT concessions in Div 152 are being used to shelter the capital gain. This may be relevant where the book value of those assets does not reflect their market value – think depreciating assets that have been written off in full due to Temporary Full Expensing or intellectual property with no acquisition cost.
- When using Subdiv 122-A roll-over and where liabilities in respect of pre-CGT assets are to be assumed by the company, in which case those liabilities cannot exceed the market value of the assets.