

# The Tax Summit

## Session 11.1: Rollovers – Practical strategy and compliance insights

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# 1. Introduction

In the current economic landscape, business owners may be considering a restructure, merger, or demerger to adapt, survive, or enable growth. A change in the structure of a business typically involves either the transfer of ownership interests in the entire business or of specific assets of the business. The disposal of an ownership interest in a business or its assets may trigger tax consequences for the business or business owners on capital or revenue account.

The distinction between capital and revenue is important to confirm as part of a restructure as significant tax concessions apply to capital assets including roll-over relief which is the focus of this paper. It is therefore imperative prior to looking into the roll-over relief provisions to confirm the asset or assets in question are indeed capital assets (or the roll-over is one that can apply to assets held on revenue account).

The general capital gains tax (CGT) provisions are in Part 3-1 and Part 3-3 of the *Income Tax Assessment Act 1997 (ITAA 1997)*.<sup>1</sup> The roll-over relief provisions provide taxpayers with the ability to disregard certain capital gains or capital losses that arise from the disposal of CGT assets where the criteria for the relevant roll-over are met.

Roll-overs are a key tool in Australian taxation, allowing entities to restructure and defer CGT until assets are ultimately realised. These issues are complex as highlighted by the Federal Court's decision in February this year in *AusNet Services Ltd*. This seminar delves into the practical aspects of using roll-overs effectively, with a focus on compliance, strategic planning, and common challenges.

The purpose of this paper is to address traps associated with CGT roll-overs. It is noted that CGT and roll-overs are a broad topic far beyond a one-hour presentation, or a paper of a sensible length, and as such this paper will focus on the following areas:

1. roll-overs 101: a quick refresher on the following rollovers;
  - Division 122 (corporatisation of assets and businesses);
  - Subdivision 124-M (scrip-for-scrip rollover);
  - Subdivision 124-N (disposal of assets by a trust to a company);
  - Division 125 (demergers);
  - Subdivision 328-G (small business restructure roll-over); and
  - Division 615 (business restructures rollover, including the decision (on appeal) in *AusNet Services Limited v Commissioner of Taxation* [2024] FCA 90); and
  - Division 152 (small business CGT concessions that include the small business roll-over);
2. practical measures to minimise risk;

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<sup>1</sup> All legislative references are to the ITAA 1997 or the *Income Tax Assessment Act 1936 (ITAA 1936)*. For ease of exposition, we only refer to the ITAA1936 or ITAA 1997 when citing references in the footnotes.

3. *Hart v FCT* [2019] FCAFC 179, a cautionary tale;
4. accessing demerger relief considering Taxation Determination TD 2020/6;
5. back-to-back roll-overs and future Australian Taxation Office (**ATO**) guidance;
6. interactions with consolidation and earnouts; and
7. the consideration of anti-avoidance provisions.

## 2. Roll-overs 101

### 2.1 A brief history of roll-over relief

Restructures involve the disposal of a business, or assets of a business, into new structures. Where the assets disposed of are capital assets their disposal will trigger a capital gain or capital loss for the selling taxpayer. Part 3-3 has most roll-overs that allow taxpayers to defer or disregard a capital gain or loss that results from this disposal. (Other roll-overs are in Division 615 and Subdivision 328-G).

CGT roll-overs were included in tax legislation to provide relief in two main circumstances. As the then Treasurer Paul Keating, in his [Second Reading speech to the Income Tax Assessment Amendment \(Capital Gains\) Bill 1986](#) on 22 May 1986 said:

Rollovers-that is, deferral of capital gains tax liability-are to be allowed for asset ownership changes associated with specified types of business reorganisations where no change occurs in the underlying ownership of the asset concerned or where the underlying assets against which the taxpayer has a claim do not change... The Government has considered the view that more general rollover relief should be available for business reorganisations on the argument that not to do so could inhibit desirable business behaviour. It has rejected this argument on equity grounds. Taken to its logical conclusion, it is virtually akin to saying that it is only the capital gains of individuals not operating businesses which should be subject to the tax.

Rollovers are also provided for certain involuntary asset disposals. These include the compulsory acquisition of assets by a government body and the theft or destruction of assets, where replacement assets are acquired within a stipulated period. In addition, in order to avoid the possibility of undue financial hardship, rollovers will apply for asset transfers between spouses incident to the breakdown of legal marriages...

Since the late 1980s more roll-over relief has been legislated which falls within the two categories highlighted above and where there is a reorganisation of a business to allow for a change in underlying economic ownership and where small businesses transfer active business assets.

Whilst there are distinct categories of roll-over relief there is not a simple “one size fits all” for businesses. It is not always possible for a taxpayer to find a CGT roll-over that satisfies all a business’s restructuring goals.<sup>2</sup> Consideration therefore needs to be given to the specific characteristics of the business, the business owners, the requirements of the provisions and the intended outcomes to determine the most appropriate roll-over or roll-overs to be undertaken.

This part of the paper is intended to provide a high-level summary of the key roll-overs which apply to interests acquired after 20 September 1985 and in some cases, interests acquired before that date. Due to the complexity of the relevant tax issues associated with each and the strict conditions of them we strongly recommend in all scenarios specific taxation advice is sought before executing a transaction pursuant to any of the roll-over reliefs.

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<sup>2</sup> In December 2019, the former Coalition Government commissioned the Board of Taxation (**BoT**) to undertake a review of CGT roll-overs. In its December 2020 [Consultation Paper](#), the BOT asked for submissions on a ‘General Business Restructure Roll-over’ that would replace many specific roll-overs. As at the date of writing, the Government has not released the BOT’s final report.

## 2.2 Division 122: corporatisation of assets and businesses

Division 122 provides roll-over relief where businesses corporatise their structure, transfer assets into a company or create rights in a corporate entity. The division has two roll-overs - Subdivision 122-A and Subdivision 122-B.

Subdivision 122-A may apply when an individual or trustee disposes of a CGT asset or all the assets of a business to a wholly owned company.<sup>3</sup> The roll-over may also apply where the individual or trustee creates a CGT asset in a wholly owned company. Where roll-over is available under Subdivision 122-A, roll-over relief may also be available under Subdivision 328-G.<sup>4</sup> The advantages and disadvantages of each should be considered before making the choice to apply any roll-over.

Subdivision 122-B applies in the same circumstances, save for the taxpayers in this circumstance being partners in a partnership rather than individuals or trustees.<sup>5</sup> However, all the partners must choose the roll-over.<sup>6</sup>

### Conditions

Subdivision 122-A allows an individual or trustee to choose to obtain roll-over if a trigger event occurs and:<sup>7</sup>

1. if there is consideration,<sup>8</sup> the only consideration received for the trigger event is non-redeemable shares in the company<sup>9</sup> and if applicable, the company undertaking to discharge one or more liabilities in respect of the asset/s of the business;
2. the market value of the shares received for the trigger event must be substantially the same as the market value of the asset/s disposed of, less any liabilities the company undertakes to discharge in respect of the asset/s (as appropriate);
3. subject to certain exceptions, the individual or trustee owns all the shares in the company just after the time of the trigger event in the same capacity as the asset/s were previously owned by the individual or trustee;
4. the ordinary income and statutory income of the company is not exempt from income tax because it is an exempt entity for the income year of the trigger event; and
5. at the time of the trigger event:
  - the individual and company are both Australian residents, or each asset must be taxable Australian property and the shares in the company are taxable Australian property just after the trigger event; or

<sup>3</sup> An asset used partly in the business is an asset of the business: see [ATO Interpretative Decision ATO ID 2005/218](#).

<sup>4</sup> Provided the assets are not shares or units. See [Law Companion Ruling LCR 2016/2](#) and footnote 16A.

<sup>5</sup> The reference to a partnership includes a reference to a tax law partnership: see [ATO Interpretative Decision \(withdrawn\) ATO ID 2004/874W](#).

<sup>6</sup> See section 122-125 ITAA 1997.

<sup>7</sup> See section 122-25 ITAA 1997. The trigger events are CGT events A1, D1, D2, D3, and F1 (see section 122-15 ITAA 1997).

<sup>8</sup> There does not need to be consideration: see [ATO Interpretative Decision ATO ID 2004/94](#).

<sup>9</sup> The consideration shares could be existing shares: see [ATO Interpretative Decision \(withdrawn\) ATO ID 2004/95W](#).

- the trustee of a trust is a resident trust for CGT purposes and the company is an Australian resident, or each asset of the trust is taxable Australian property and the shares in the company are taxable Australian property just after the trigger event; and
6. the choice to obtain roll-over is made by the day the individual or trustee lodges its income tax return for the income year in which the CGT event happened, or within a further time allowed by the Commissioner of Taxation (**Commissioner**).<sup>10</sup>

Sections 122-35 and 122-37 deal with the case where the company to whom an asset or assets are transferred undertakes to discharge one or more liabilities in respect of the asset or assets (a 'disposal case').

Where a single asset is transferred to the company, the liabilities the company undertakes to discharge cannot exceed:<sup>11</sup>

1. if the asset is a post-CGT asset - the cost base of the asset; or
2. if the asset is a pre-CGT asset - the market value of the asset.

If all the assets of a business are transferred to the company, the liabilities the company undertakes to discharge cannot exceed:<sup>12</sup>

1. if all the assets are post-CGT assets - the sum of the market values of the precluded assets and the cost bases of the other assets;
2. if all the assets are pre-CGT assets - the sum of their market values;
3. if the assets consist of both post-CGT and pre-CGT assets (or at least one of each) - for the post-CGT assets, the sum of the market values of the precluded assets and the cost bases of the other assets and, for the pre-CGT assets, the sum of their market values.

In all cases, the cost base or market value of an asset is worked out when the asset is transferred.

The consequences that arise under a disposal (CGT event A1) case are:<sup>13</sup>

1. a capital gain or capital loss is disregarded if the individual or trustee chooses to obtain roll-over under Subdivision 122-A;
2. the first element of each share's cost base is the asset's cost base when the individual or trustee disposed of it (less any liabilities the company undertakes to discharge in respect of it) divided by the number of shares;
3. shares in the company are treated as pre-CGT assets to the extent the asset/s disposed of to the company were pre-CGT assets;<sup>14</sup>

<sup>10</sup> Section 103-25 ITAA 1997.

<sup>11</sup> Section 122-35 ITAA 1997.

<sup>12</sup> Section 122-35 ITAA 1997.

<sup>13</sup> Sections 122-40, 122-50, 122-55 and 122-70 ITAA 1997.

<sup>14</sup> However, the shares are not treated as pre-CGT for the 'holding period' and 'related payment' rules contained in former Division 1A of Part IIIA ITAA 1936: see [ATO Interpretative Decision ATO ID 2006/31](#).

4. for each CGT asset (except a precluded asset)<sup>15</sup> disposed of to a company where roll-over is chosen under Subdivision 122-A, the first element of the asset's cost base in the hands of the company is the asset's cost base at the time of disposal;
5. each pre-CGT asset (except a precluded asset) preserves its status as a pre-CGT asset owned by the company.<sup>16</sup>

### **Example**

Phoenix is an accountant operating a business as a sole trader. The business has had substantial growth and turns a healthy profit. Phoenix runs this business from her study at home. The business assets are office equipment, registered intellectual property, and (internally generated) goodwill. The cost base of the business assets is \$20,000.

Phoenix has decided to corporatise her business and has been advised by a professional valuer that the current market value of the business is \$2,000,000. Phoenix transfers the assets of the business to a new wholly owned company in exchange for the company issuing Phoenix with 2,000,000 \$1 ordinary shares.

Phoenix makes a \$1,800,000 capital gain (being the market value of the shares received less the assets' cost base). Subdivision 122-A allows Phoenix to disregard this capital gain where Phoenix meets the requirements of that subdivision. Under the roll-over the company inherits Phoenix's cost base in the business assets.

Subdivision 122-B would apply in a similar way if instead of Phoenix being a sole trader, she conducted the business in partnership and Phoenix and the other partners transferred the business assets to the company.

## **2.3 Division 124: replacement asset roll-overs**

Division 124 has roll-overs referred to as 'replacement-asset' roll-overs.<sup>17</sup> Under a replacement-asset roll-over the taxpayer's ownership in one CGT asset ends and they acquire a new CGT asset. There are various roll-overs contained in Division 124, however in this paper we will address the most common being Subdivision 124-M and Subdivision 124-N.

### **2.3.1 Subdivision 124-M: scrip-for-scrip roll-over**

The roll-over relief contained in Subdivision 124-M and referred to as a 'scrip for scrip' roll-over allows a taxpayer to choose to disregard a capital gain made when the taxpayer exchanges shares or trust interests for other shares or trust interests.<sup>18</sup> The taxpayer's cost base from their original asset is generally transferred to their replacement interest.<sup>19</sup> Unlike other roll-overs, Subdivision 124-M allows

<sup>15</sup> Precluded assets include depreciating assets, trading stock, and registered emissions units: see subsection 122-25(3) ITAA 1997.

<sup>16</sup> For purposes of the CGT discount, sections 115-25 and 115-40 ITAA 1997 apply as if any shares acquired under a Subdivision 122-A roll-over were acquired 12 months before the CGT event.

<sup>17</sup> Other replacement-asset roll-overs are contained in other divisions of the ITAA 1997.

<sup>18</sup> Section 124-775 ITAA 1997.

<sup>19</sup> Section 124-785 ITAA 1997.



a partial roll-over where the capital proceeds include something, such as cash, other than replacement share or trust interest.<sup>20</sup> For the ineligible proceeds (cash), no roll-over is available.<sup>21</sup>

## Conditions

Where an entity (**original interest holder**) would make a capital gain from a CGT event happening in relation to their share, option, right or similar interest (**original interest**) they may access the Subdivision 124-M roll-over relief provided:

1. the original interest holder exchanges their original interest in a company (**original entity**) for a share or an option, right, or similar interest that gives the holder an entitlement to acquire a share (**replacement interest**) in another company;<sup>22</sup> and
2. the exchange is in consequence of a single arrangement that results in either a company (**acquiring entity**) that is not a member of a wholly-owned group becoming the owner of 80% or more of the voting shares in the original entity or a company (also an **acquiring entity**) that is a member of a wholly-owned group increasing the percentage of the voting shares that it owns in the original entity, and that company or members of the group becoming the owner of 80% or more of those shares;<sup>23</sup> and
  - be one in which at least all owners of voting shares in the original entity (except the acquiring entity) could participate; and
  - be one in which participation was available on substantially the same terms for all the owners of interest if a particular type in the original entity;<sup>24</sup> and
3. the replacement interest must be in a company (**replacement entity**) that is:
  - not a member of a wholly owned group; or
  - the ultimate holding company of the wholly owned group; and
4. if an acquiring entity is a member of a wholly owned group; no member of the group issues equity (other than a replacement interest), or owes new debt, under the arrangement, to an entity that is not a member of the group and in relation to the issuing of the replacement interest.<sup>25</sup>

Importantly, Subdivision 124-M roll-over is not available where the original interest holder acquired the interest before 20 September 1985. While a capital gain may be able to be disregarded for being a

<sup>20</sup> Section 124-784B(3) ITAA 1997.

<sup>21</sup> Section 124-790 ITAA 1997. Ineligible proceeds can include earnout rights to shares: see [ATO Interpretative Decision ATO ID 2002/100](#).

<sup>22</sup> The foreign company does not need to be an Australian company: see, for example, [ATO Interpretative Decision ATO ID 2010/9](#).

<sup>23</sup> The percentage can 'increase' even if the interest is zero before the transaction: see [Taxation Determination TD 2000/51](#).

<sup>24</sup> The terms of the shares do not need to be identical as long as those as the shares are of the same type: see [ATO Interpretative Decision ATO ID 2004/800](#). Similarly, redeemable preference shares can also be exchanged for ordinary shares: see [ATO Interpretative Decision ATO ID 2003/893](#). However, shares cannot be exchanged for units: see [ATO Interpretative Decision ATO ID 2003/197](#). Different offers can also be made to owners of different types of shares: see [ATO Interpretative Decision ATO ID 2003/177](#).

<sup>25</sup> The Explanatory Memorandum to the [Tax and Superannuation Laws Amendment \(2015 Measures No. 4\) Bill 2015](#) suggests external financing does not breach this requirement: see Example 1.6.

pre-CGT asset, the replacement interest will be post-CGT with a cost base equal to market value at the time of the transaction.<sup>26</sup>

#### *Significant stakeholders and common stakeholders*

If the original interest holder is a significant stakeholder or a common stakeholder, it and the replacement entity must jointly choose to obtain the roll-over. The original interest holder must inform the replacement entity in writing of the cost base of its original interests which the replacement entity then uses as its cost base.

The significant stakeholder and common stakeholder provisions require comparing the 'significant' or 'common' stakes in the original entity and replacement entity just before and after the arrangement and are measures to ensure that Subdivision 124-M roll-over is not inappropriately used to "step up" cost base to market value. These provisions should be considered when undertaking a Subdivision 124-M roll-over.

#### *Non-arm's length transactions*

If the original interest holder and an acquiring entity did not deal with each other at arm's length and:

1. neither had at least 300 members just before the arrangement started; or
2. the original interest holder, the original entity and an acquiring entity were all members of the same linked group just before that time,

then:

1. the market value of the original interest holder's capital proceeds for the exchange must be at least substantially the same as the market value of its original interest; and
2. the replacement interest must carry the same kind of rights and obligations as those attached to its original interest.<sup>27</sup>

#### *Section 124-784A restructures*

The rules in sections 124-784A/124-784B were introduced to prevent cost base step ups when forming consolidated groups. A single arrangement will be taken to be a restructure if:

1. the replacement entity for the arrangement knows, or could reasonably be expected to know:
2. that a scrip for scrip roll-over has been, or will be, obtained in relation to the arrangement; and
3. that there is a common stakeholder for the arrangement; and
4. just after the arrangement was completed (the completion time), the market value of the replacement interests issued by the replacement entity under the arrangement, or under an earlier arrangement that was taken to be a restructure, in exchange for qualifying interests in the original entity is more than 80% of the market value of all the shares (including options, rights and similar interests to acquire shares) issued by the replacement entity.

Where an arrangement is taken to be a restructure, the cost base and reduced cost base of the qualifying interests acquired in the original entity are worked out by applying the method statement in

<sup>26</sup> A capital gain from CGT event K6 is also disregarded: see subsection 104-230(10) ITAA 1997.

<sup>27</sup> Section 124-780 ITAA 1997.

section 124-784B. (However, the modifications do not apply if the cost base and reduced cost base of the qualifying interests is worked out under section 124-782, because the common stakeholder rules in section 124-783 apply to the arrangement).

### *Making a Choice*

The taxpayers must choose to obtain the roll-over relief.<sup>28</sup> However, relief under Subdivision 124-M is not available in the following circumstances:

1. just before the original interest holder stops owning the original interest, the original interest holder is a foreign resident (unless, just after the replacement interest is acquired, the replacement interest is taxable Australian property);<sup>29</sup>
2. roll-over can be chosen under Divisions 122 or 615;<sup>30</sup>
3. the replacement entity makes a choice to the effect that an original interest holder cannot obtain roll-over under Subdivision 124-M and the original entity, or the replacement entity notifies the original interest holder in writing of the choice before the exchange.<sup>31</sup>

### **Example**

Phoenix owns 200,000 shares in Original Co which have a cost base of \$20,000 and a market value of \$200,000. New Co (which has numerous shareholders) decides to acquire all of Phoenix's shares in Original Co and in exchange issue shares in New Co to Phoenix.

In the absence of a Subdivision 124-M roll-over Phoenix would make a capital gain of \$180,000. Under Subdivision 124-M Phoenix can disregard that capital gain. New Co's cost base in Original Co would be \$200,000 or \$20,000 if Phoenix were a significant stakeholder.

## **2.3.2 Subdivision 124-N: disposal of assets by a unit trust to a company**

Subdivision 124-N provides roll-over relief where a trust to which CGT event E4 can happen – typically a unit trust - disposes all its assets to a company and unitholders in the unit trust receive shares in the company.<sup>32</sup> This roll-over is not available for discretionary trusts.<sup>33</sup>

Apart from only being available to unit trusts, a Subdivision 124-N roll-over differs from a Subdivision 122-A roll-over as the 122-A roll-over requires the unit trust to be the only shareholder of the company after the restructuring. By contrast under the 124-N roll-over, the transaction effectively converts the trust into a company with the unitholders now becoming shareholders.

<sup>28</sup> The choice must comply with section 103-25 ITAA 1997. The choice could be at the time of the roll-over or based on the preparation of the tax return.

<sup>29</sup> Section 124-795(1) ITAA 1997.

<sup>30</sup> Section 124-795(3) ITAA 1997.

<sup>31</sup> Section 124-795(4) ITAA 1997.

<sup>32</sup> Section 124-850 ITAA 1997.

<sup>33</sup> Section 124-855 ITAA 1997. This includes where some of the interests in the trust are discretionary: see [ATO Interpretative Decision ATO ID 2002/955](#).

## Conditions

The following key conditions must be satisfied:<sup>34</sup>

1. all assets of the unit trust must be transferred to the company within the trust restructure period (which generally commences when the first asset is transferred from the unit trust to the company);<sup>35</sup>
2. unless the company is the trustee of the unit trust,<sup>36</sup> the company must never have carried on commercial activities and have no CGT assets;
3. the unitholders must own shares in the company in the same proportion as their unit holding in the unit trust after the restructure;
4. the market value of the issued shares each unitholder owns must be substantially the same as the market value of their units in the unit trust;
5. the company and the unit trust must both elect to obtain the roll-over; and
6. the unit trust must be wound up within six months of the restructuring period (subject to a limited extension).<sup>37</sup>

### Example

Phoenix owns 55% of the units and Xavier owns 45% of the units in a unit trust. The trustee of the unit trust transfers all its CGT assets to a newly incorporated company, New Co. In exchange New Co issues shares to Phoenix and Xavier in proportion to their interests in the unit trust (55% and 45%). The Unit Trust is wound up within 6 months of the restructuring period.

## 2.3.3 Subdivision 125: demerger relief

Owners of interests in a head entity can obtain roll-over relief to defer the CGT consequences that arise under a demerger. The object of Division 125 is to enable entities to demerge without CGT impediments.

A demerger refers to the restructuring of corporate entities or group or trust entities or group by splitting the entities or group into one or more entities or groups. For demerger relief to be available, section 125-70 requires the following:

1. there must be a restructuring of the demerger group;

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<sup>34</sup> Section 124-870 ITAA 1997.

<sup>35</sup> Assets may be left in the trust to pay debts: see section 124-860. If the assets are not needed to satisfy the debts, or remain after the debts are satisfied, it does not obviate the roll-over: see [ATO Interpretative Decision ATO ID 2003/340](#) and [ATO Interpretative Decision ATO ID 2003/341](#).

<sup>36</sup> If the trustee starts owning in its own capacity a CGT asset that it owned as trustee, CGT event A1 happens: see [ATO Interpretative Decision ATO ID 2010/72](#).

<sup>37</sup> CGT event J4 happens if the trust is not wound up within 6 months of the start of the restructuring period unless it is due to circumstances beyond the trustee's control: section 104-195 ITAA 1997. CGT event J4 happens to the company and its shareholders, not the trustee.

2. under the restructuring members of the demerger group must dispose of **at least 80%** of their total ownership interests to other members of the demerged group;
3. the shareholders must only obtain shares in the demerged group **and nothing else**; and
4. the shareholders must acquire, under the demerger, the same proportion of new interests (**same proportionate total market value** of ownership interests) in the demerged group as they owned in the head entity just before the demerger.

A key element of demerger relief is that a restructuring occurs. We discuss this in further detail below in Part 5 of this paper.

The CGT consequences of a demerger are dependent on whether the taxpayer is the owner of an ownership interest in the head entity of a demerger group, as opposed to a member of the demerger group. Broadly speaking:

1. owners of an ownership interest can elect for the demerger roll-over to happen, whereas members of the demerger group cannot choose to apply the roll-over;
2. for owners of an ownership interest, the first element of the cost base and reduced cost base of each new interest is a proportion of the sum of the cost bases of the post-CGT original interests, just before the demerger;<sup>38</sup>
3. for members of the demerger group, only capital gains or losses made from CGT events A1, C2, C3 or K6 are disregarded in relation to the exchange of its ownership interests in the demerged entity, and CGT event J1 does not happen if CGT events A1 or C2 arise.

#### **Example**

Phoenix and Xavier own all the shares in HeadCo which owns SubCo. HeadCo and SubCo carry on unrelated businesses. Under a restructuring, HeadCo makes an in-specie distribution of all SubCo's shares to Phoenix and Xavier.

### **2.3.4 Subdivision 328-G: small business restructure roll-over**

This is the only CGT roll-over which allows the transferee to be a discretionary trust. Roll-over relief under Subdivision 328-G is available where an entity (the **transferor**), under a transaction, transfers an asset to one or more other entities (the **transferees**).

Key requirements to be satisfied under this Subdivision include:<sup>39</sup>

1. the transaction is, or is part of, a genuine restructure of an on-going business;
2. each party to the transfer (and their affiliates or connected entities), including a partner in a partnership, is a small business entity for the income year of the transfer;
3. the transaction does not have the effect of materially changing which individual has, or which individuals have, ultimate economic ownership of the asset, or each individual's share of that ultimate economic ownership; and

<sup>38</sup> Subsection 125-80(2) ITAA 1997.

<sup>39</sup> Section 328-430 ITAA 1997.

4. the asset is a CGT asset (other than a depreciating asset) that is, at the time the transfer takes effect:
  - an active asset of a small business entity;
  - an active asset of an affiliate of connected entity that is a CGT small business entity; or
  - an active asset and an interest in an asset of the partnership;
5. the transferor and each transferee:
  - meet the residency requirements in section 328-445 (broadly, the transferor and transferee must be Australian residents for tax purposes); and
  - choose to apply the roll-over in relation to the assets transferred under the transaction.

Roll-over under Subdivision 328-G does not require consideration. However, this lack of a requirement must be considered considering duties under (say) the *Corporations Act 2001* and a trustee's equitable duties. Other legislation outside of the ITAA 1936 or the ITAA 1997 can also deem market value consideration in certain circumstances. For example, GST, duty, and land tax Acts.

A special rule has been included to determine the ultimate economic ownership of discretionary trusts, which broadly requires that, just before and just after the transaction, the same members of the family group maintain ultimate economic ownership of property included in a family trust. The rule is that a transaction will not have the effect of changing the ultimate economic ownership if:<sup>40</sup>

1. before and after the transaction the asset was included in the property of a non-fixed (discretionary) trust that is a family trust (as defined in Schedule 2F); and
2. before and after the transaction every individual who had the ultimate economic ownership of the asset was a member of the family group (as defined in Schedule 2F).

Subdivision 328-G includes a safe harbour rule as an alternative to the "genuine restructure" test where the following conditions are met in the 3-year period after the transaction takes effect:<sup>41</sup>

1. there is no change in the ultimate economic ownership of any of the significant assets (other than trading stock) that were transferred under the transaction;
2. those significant assets continue to be active assets; and
3. there is no material or significant use of those significant assets for private purposes.

It is possible that a transaction that does not meet the safe harbour could still be a "*genuine restructure of an ongoing business*". The meaning of "*genuine restructure of an ongoing business*" is a question of fact to be determined having regard to all facts and circumstances surrounding the restructure. The [Explanatory Memorandum to the Tax Laws Amendment \(Small Business Restructure Roll-over\) Bill 2016 \(Explanatory Memorandum\)](#) and [Law Companion Ruling LCR 2016/3](#) contain guidance on what is a "*genuine restructure of an ongoing business*".

<sup>40</sup> Section 328-440 ITAA 1997.

<sup>41</sup> Section 328-435 ITAA 1997.

The transfer of an asset for which roll-over is available under Subdivision 328-G should have no direct consequences under the income tax law.<sup>42</sup> This should include under Division 7A where assets are transferred for no consideration although if consideration is provided Division 7A will need to be complied with. The Explanatory Memorandum at paragraph 1.50 also suggests that Part IVA could still apply.

Roll-over under Subdivision 328-G extends to trading stock, revenue assets, and depreciating assets.

A transferee is taken to have acquired a CGT asset (other than a revenue asset) that is a pre-CGT asset before 20 September 1985.<sup>43</sup>

For access to the 15-year small business CGT exemption under Subdivision 152-B, the transferee is treated as having acquired the asset at the time the transferor acquired the asset.<sup>44</sup> However, for access to the 50% CGT discount, the acquisition time is the time at which the transferee acquires the asset.<sup>45</sup>

### 2.3.5 Division 615: business restructures roll-over

Division 615 was introduced in 2014 with the intention to consolidate former Subdivisions 124-G and 124-H. There are some slight variances to the provisions when consolidated into Division 615.

Division 615 applies in circumstances where a company is interposed (**Interposed Entity**) into a structure to acquire all the shares in an existing company or all the units in a trust (**Original Entity**). This process is commonly referred to as “top hatting”. The roll-over relief will apply to disregard any resulting capital gain or loss.

Like all roll-over reliefs there are several criteria to be satisfied for Division 615 to apply. The first and most important of these is that there is no change in the economic ownership of the underlying asset or assets. Where new economic owners are entering the structure Division 615 will not be applicable and advisors will need to look at alternate steps to preserve existing owners’ access to roll-over relief.

Additional key criteria in Division 615 are as follows:<sup>46</sup>

1. the taxpayer and at least one other entity (**exchanging members**) own all the shares in a company or units in a unit trust (**original entity**); and
2. under a scheme for organising the entity’s affairs, either:
  - the exchanging members dispose of all their shares or units to a company (**interposed company**) in exchange for non-redeemable shares in the holding company and nothing else; or
  - the interposed entity acquires one or more, but not all, of the shares or units in the original entity, these are the first shares or units that the interposed entity acquires in the original entity, the exchanging members own all the remaining shares or units;

<sup>42</sup> Section 328-450 ITAA 1997.

<sup>43</sup> Section 328-460 ITAA 1997.

<sup>44</sup> Section 328-450 ITAA 1997.

<sup>45</sup> Section 328-115 ITAA 1997.

<sup>46</sup> Section 615-15 ITAA 1997.

- in the original entity, those remaining shares or units are redeemed or cancelled, and each exchanging member receives shares and nothing else in the interposed company in return for their shares or units in the original entity being redeemed or cancelled; and
- the holding company must own all the shares or units in the original entity immediately after the completion time; and
- the original shareholders must own all the shares in the holding company, in whole numbers and which are reflective of their proportionate interest in the original entity and equal to 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 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); and
- either:
  - the taxpayer is an Australian resident at the time their shares or units in the original entity are disposed of, redeemed, or cancelled under the scheme; or
  - the taxpayer is a foreign resident at that time and their shares or units in the original entity were taxable Australian property immediately before that time and their shares in the interposed company are taxable Australian property immediately after the completion time; and
  - each exchanging member who is issued shares in the interposed company owns the shares from the time they are issued until at least the completion time and immediately after the completion time:
  - the exchanging members own all the shares in the interposed company; or
  - entities other than those members must own no more than 5 shares in the interposed company, and the market value of those shares expressed as a percentage of the market value of all the shares in the interposed company must be such that it is reasonable to treat the exchanging members as owning all the shares.

The interposed company must make an irrevocable choice under section 615-30. This deals with the consequences for the interposed company.

### **Consequences of roll-over under Division 615**

Broadly, the consequences of roll-over under Division 615 are that:<sup>47</sup>

1. the taxpayer disregards any capital gain or capital loss made from the disposal, redemption, or cancellation of shares or units in the original entity;
2. the taxpayer works out the first element of the cost base of each new share in the interposed entity by reference to the cost bases of the taxpayer's shares or units in the original entity; and
3. if the taxpayer acquired the shares or units in the original entity before 20 September 1985, the taxpayer is taken to have acquired the shares in the interposed entity before that date.

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<sup>47</sup> Subdivision 615-C ITAA 1997.



Roll-over under Division 615 also extends to shares or units held as trading stock or revenue assets.<sup>48</sup>

The interposed company is taken to have acquired a number of shares or units in the original entity before 20 September 1985 if any of the original entity's assets as at the completion time were acquired by the original entity before that day.<sup>49</sup>

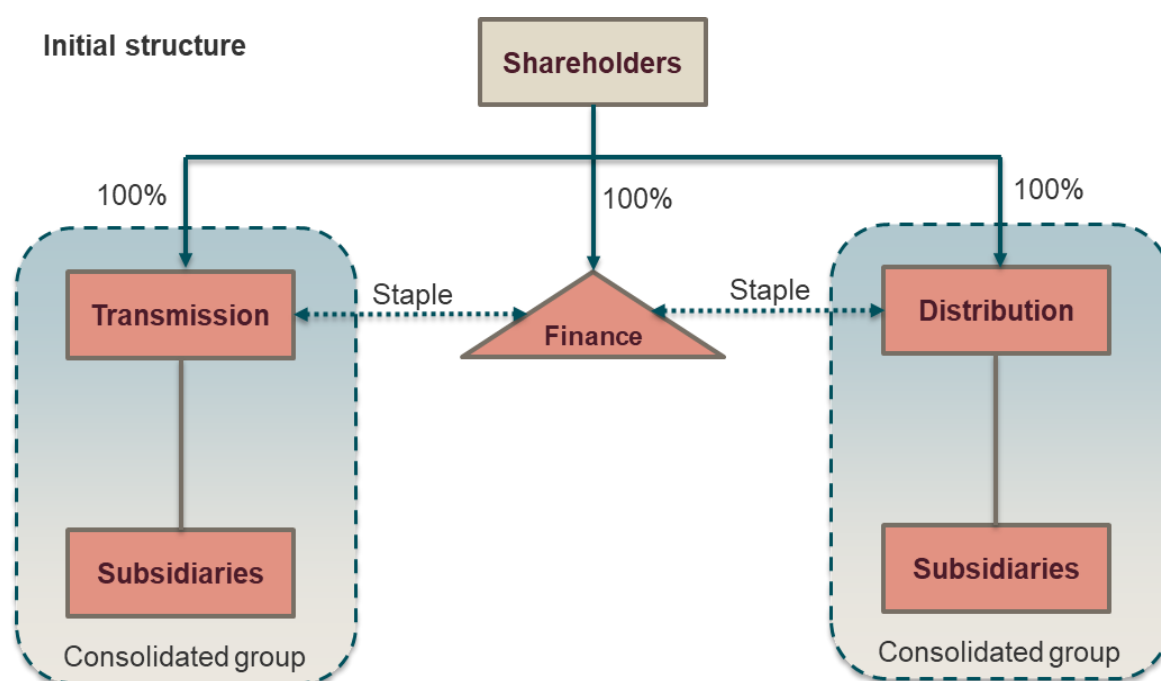
The first element of the cost base of the interposed entity's shares or units in the original entity that are not taken to have been acquired before 20 September 1985 is the total of the cost bases at the completion time of the original entity's assets that it acquired after that date less its liabilities in respect of those assets.<sup>50</sup>

### AusNet and Division 615 roll-over

It is unusual that the courts look to whether the requirements of a roll-over are met. However, that happened on 16 February 2024 when Hesse J of the Federal Court delivered judgment in [AusNet Services Limited v Commissioner of Taxation \[2024\] FCA 90](#), holding that Division 615 applied to a scheme of arrangement by AusNet Services Limited (**AusNet**) during the year ended 30 June 2015.

The AusNet group was a triple-stapled structure, made up of two companies, AusNet Services (Transmission) Limited (**Transmission**) and AusNet Services (Distribution) Limited (**Distribution**), both with their own consolidated groups, and a trust, AusNet Services Finance Trust (**Finance**).

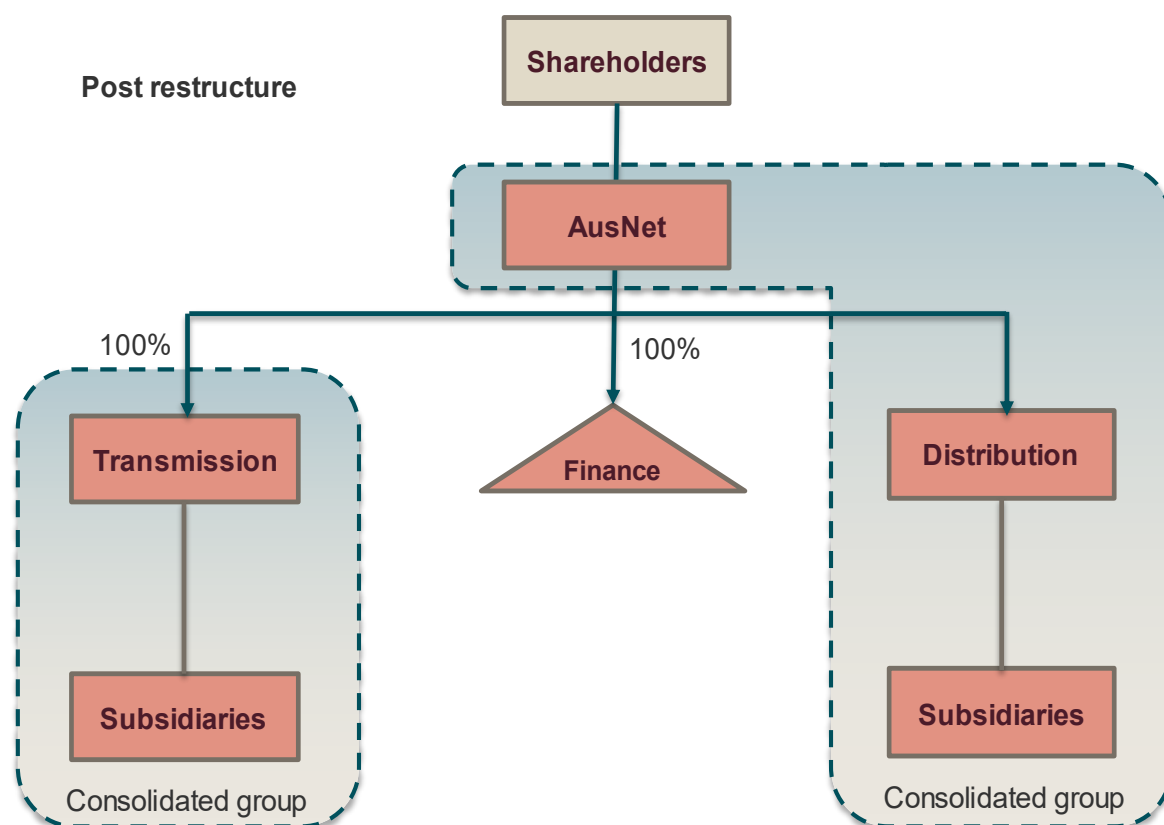
On 18 June 2015, the AusNet group decided to un-staple and roll-over each of the entities into a shelf company, AusNet, which would become the new head company of the (former) Distribution consolidated group. After the three companies were unstapled, AusNet acquired each of the three entities under scrip-for-scrip exchanges in the following order, Transmission, then Finance, then Distribution. The pre-and-post structures of the AusNet group are shown below.



<sup>48</sup> Subdivision 615-C ITAA 1997.

<sup>49</sup> Section 615-65 ITAA 1997.

<sup>50</sup> Section 615-65 ITAA 1997.



On 1 July 2015, the Commissioner issued [Class Ruling CR 2015/45](#) saying that Division 615 roll-over relief would apply to the restructure under Division 615. However, AusNet objected to income tax assessments issued to it on the basis that Division 615 did not apply to the scheme of arrangement by which it came to be the holder of shares in Distribution.<sup>51</sup> This would entitle AusNet to an uplift in the cost bases of assets formerly held by the Distribution income tax consolidated group.

The Commissioner denied the objections and AusNet appealed to the Federal Court saying 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 AusNet as the interposed company at the time of the Distribution scheme. That is, AusNet was not of a “shelf company.” Instead, because AusNet had already acquired Transmission and Finance, it was a company with significant value. More specifically, AusNet argued:

1. the requirement under paragraph 615-5(1)(c) that the Distribution shareholders, under a ‘scheme for reorganising its affairs’, disposed of all their Distribution shares to AusNet in exchange for shares in AusNet and ‘nothing else’ was not satisfied; and
2. the ratio under paragraph 615-20(2)(a) in relation to the Distribution scheme did not equal the ratio calculated under paragraph 615-20(2)(b), which is a precondition to the application of Division 615.

Hespe J held that:

1. paragraph 615-5(1)(c) required, by its terms, a focus on that which a shareholder receives under the scheme in exchange for the shares. It does not look to the consequences of the scheme, but rather the consideration or quid pro quo received for the disposal of the shares. Hence, the scheme satisfied the description of paragraph 615-5(1)(c);

<sup>51</sup> AusNet did not dispute that Division 615 applied to the Transmission and Finance schemes.

2. whilst the scheme was a restructure of the affairs of Distribution and its associated entities, not just Distribution, under the terms of the Distribution scheme of arrangement, the Distribution shareholders in fact received one share in AusNet in exchange for the disposal of each Distribution share and “nothing else”; and
3. the ratio comparison required by subsection 615-20(2) is seeking to ascertain whether at the completion of the scheme, the proportionate interest of each exchanging member in the market value of the interposed entity is the same as the proportionate interest that exchanging member held in the market value of the original entity, before the scheme.

Hespe J went on to state that AusNet’s construction of paragraph 615-20(2)(a) was founded on the implicit importation into Division 615 of a requirement that the interposed company be a “shelf company.” On AusNet’s construction, the ratio in paragraph 615-20(2)(a) does not equal the ratio in paragraph 615-20(2)(b) unless the interposed is a “shelf company” prior to the scheme being carried out.

It was not disputed that prior to the implementation of the schemes on 18 June 2015, AusNet was a “shelf company.” AusNet’s submission was that it was not a shelf company just before the Distribution scheme took place because the Distribution scheme took place after the Transmission scheme and the Finance scheme. At that time, AusNet was a company of significant value. The result, it was said, was that the ratios were not equal because the Distribution shareholders already held shares of substantial value in AusNet, immediately prior to the disposal of their Distribution shares.

However, Hespe J found that when understood in context, the Distribution scheme of arrangement implemented on 18 June 2015 was a scheme for reorganising the affairs of Distribution. The fact that the Distribution scheme was undertaken as part of a broader scheme involving schemes relating to Transmission and Finance did not alter the fact. Expressly, a requirement that the interposed company be a shelf company is not found in the express terms of the operative provisions of Division 615.

AusNet has appealed to the Full Federal Court. If the Full Federal Court upholds Hespe J’s decision on the same basis then there are several implications for taxpayers:

1. the priority by Hespe J to the economic substance of the overall arrangement over the legal form arguably provides for a broader application of Division 615 than the Commissioner has previously acknowledged;<sup>52</sup>
2. the narrow construction of the ‘and nothing else’ requirement such that it concerns only the “*quid pro quo received for the disposal of the shares*” and not the consequences of the scheme; and
3. clarification on the appropriate construction of the ratios at subsection 615-20(2), which makes it clear that Division 615 can apply to interposed companies with existing substantial value and not just shelf companies and may simplify Division 615 rollovers by rendering redundant additional transaction steps such as any need to cancel “original shares”.

<sup>52</sup> See, for example, [Taxation Ruling TR 97/18](#), wherein, in the context of a predecessor provision to Division 615, the Commissioner refers to an apparent requirement that an interposed company must be a ‘shelf company’.

## 2.3.6 Division 152: small business CGT concessions

For smaller groups, and for ‘active’ assets, the small business CGT concessions (**Concessions**) in Division 152 can be an alternative to CGT roll-overs. To access the Concessions a CGT event must happen in relation to a CGT asset, which is an active asset.

Subdivision 152-A requires that certain basic conditions must be satisfied to access any of the **Concessions**. Some of the Concessions have added specific conditions that must also be satisfied.

### Basic conditions for the Concessions

The basic conditions in Subdivision 152-A are a set of technical rules that govern the ability to access the Concessions.

To access the Concessions four basic conditions must be satisfied. The first is that a “CGT event” (for example, a transfer, sale, or disposal) must happen in relation to a “CGT asset” (for example, land).

The second is because of the CGT event, a capital gain must arise (for example, for CGT event A1, the capital proceeds from the disposal exceed the asset’s cost base).

The third is typically at least one of the following must apply:

1. the taxpayer is a “CGT small business entity” (**CGT SBE**) for the income year in which the CGT event occurs; or
2. the taxpayer satisfies the maximum net asset value test (**MNAV Test**) just before the CGT event.

It is generally the case that the entity which owns the CGT asset and triggers the CGT event (that is, the taxpayer) must either be a CGT SBE or satisfy the MNAV Test to satisfy the third basic condition. However, it is also possible for a taxpayer who owns a CGT asset to satisfy the third basic condition provided:

1. the taxpayer’s “affiliate”, or an entity that is “connected with” the taxpayer, is a CGT SBE for the income year;
2. the taxpayer does not carry on a business in the income year; and
3. the CGT SBE referred to above is the entity that, at a time in the income year, carries on the business in relation to the CGT asset (for the purposes of the “active asset test.”)

For partners in a partnership there are alternative ways to satisfy the third condition. These depend on whether the “CGT asset” is an “interest in an asset of the partnership” and whether the partner carries on a business other than in their capacity as a partner in a partnership. The Commissioner’s view is that all partners in a general law partnership carry on a business in their own right.<sup>53</sup>

Where a CGT asset owned by a partner is used in the business carried on by the partnership (for example, the CGT asset is **not** an “interest in an asset of the partnership,”), and the partner does not carry on a business other than in their capacity as a partner in the partnership, the Concessions will be available provided:

1. the partnership is a CGT SBE for the income year of the CGT event; and

<sup>53</sup> [ATO Interpretative Decision ATO ID 2003/359](#).

2. the CGT asset must be used in (or held ready for use in or be inherently connected with) the partnership business at a time in the income year in which the CGT event happens.<sup>54</sup>

The fourth basic condition is the CGT asset satisfies the active asset test.

#### *CGT SBE test*

A CGT SBE is an entity which carries on a business and:

1. has an “aggregated turnover” of under \$2 million in the previous income year;
2. is likely to have an “aggregated turnover” of under \$2 million in the current income year (**Likely Test**); or
3. actually has “aggregated turnover” of under \$2 million in the current income year.

Whether an entity carries on a business is a question of fact and degree (as it is not statutorily defined), although it is generally accepted that for the purposes of the Concessions companies will carry on a business (as per the Commissioner’s view in [Taxation Ruling TR 2019/1](#)).

“Aggregated turnover” is the ordinary business income of the entity, together with the ordinary business income of any entity that it is “connected with” or is an “affiliate” of the entity. It does not include income from non-business activities, or from related party dealings.

The Likely Test is objective and asks, on the balance of probabilities, whether it is more likely than not that an entity’s aggregated turnover will be under \$2 million.

#### *MNAV Test*

A taxpayer will satisfy the MNAV Test if, just before the CGT event the sum of the following amounts does not exceed \$6,000,000:

1. the net value of the CGT assets of the taxpayer;
2. the net value of the CGT assets of entities connected with the taxpayer; and
3. the net value of the CGT assets of any affiliates of the taxpayer or entities connected with the taxpayer’s affiliates.

The net value of the CGT assets of an entity is equal to the market value of the assets less any liabilities related to the assets and less certain provisions. This test excludes assets owned by individuals used solely for personal use and enjoyment, as well as a main residence and investments in a complying superannuation fund.

In the context of the disposal or sale of a CGT Asset, CGT event A1 typically occurs at the time that the contract which gives effect to the disposal is signed by the parties (not at the time of settlement).

#### *Aggregation under the “connected with” requirement*

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<sup>54</sup> Subsection 152-10(1B) ITAA 1997.

The “connected with” requirement has the effect of grouping the ordinary annual turnovers of the taxpayer (for the purpose of the CGT SBE Test) or the net assets of the taxpayer (for the purposes of the MNAV Test) with any entities that control or are controlled by the taxpayer. This in turn depends on the type of entity being tested. For example:

1. the ordinary annual turnover/net assets of a company will be grouped with a taxpayer’s ordinary annual turnover/net assets if the taxpayer owns, or has the right to acquire the ownership of, equity interests in the company that carry between them the right to exercise, or control the exercise of, a percentage that is at least 40% of the voting power in the company;
2. the ordinary annual turnover/net assets of a discretionary trust will be grouped with the taxpayer’s if:
  - the taxpayer significantly influences or controls the trustee of the discretionary trust; or
  - if, in one of the past four income years, the taxpayer has received at least 40% of the discretionary trust’s income or capital.

The breadth of the “connected with” test includes indirect relationships, so that if A directly controls B, and B directly controls C, then A will indirectly control C and all income /net assets between A, B, and C will be grouped. It also groups affiliates (as discussed below).

Trustees and members of self-managed super funds (**SMSFs**) are not “connected with” SMSFs. This is because SMSFs do not distribute income or capital but instead pay benefits in the form of pensions or lump sums on the occurrence of certain events, such as retirement.<sup>55</sup>

#### *Affiliate test*

In addition to the above, the “affiliate” test may also result in the ordinary annual turnover or net asset value of other individuals or companies being included in a taxpayer’s aggregated turnover or net asset value.

The meaning of an affiliate is defined in section 328-130 as:

An individual or a company is an affiliate of yours if the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, in relation to the affairs of the business of the individual or company.

However, an individual or a company is not your affiliate merely because of the nature of the business relationship you and the individual or company share.

The section 328-130 definition indicates that only individuals and companies which carry on a business can be affiliates.

#### *Active Asset and Active Asset Test*

For the Concessions to apply the “active asset test” must also be satisfied.

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<sup>55</sup> See [Taxation Determination TD 2006/68](#).

A CGT asset is an “active asset” at a time if it is owned by the taxpayer and it is used or held ready for use in the course of carrying on a business that is carried on by the taxpayer, their affiliate, or an entity connected with the taxpayer.

An asset cannot be an active asset if its main use is to derive rent, interest, or other similar forms of passive income, unless it is used by an entity “connected with” the asset owner for business purposes.

A CGT asset satisfies the “active asset test” if:

1. the taxpayer has owned the asset for 15 years or less and the asset was an active asset of the taxpayer for a total of at least half of the test period; or
2. the taxpayer has owned the asset for more than 15 years and the asset was an active asset of the taxpayer for a total of at least 7 ½ years during the test period.

The ‘test period’ begins when the asset is acquired. The test period ends the earlier of the CGT event, or when the business ceased.

### **Additional basic conditions for shares and trust interests**

If the asset the subject of a CGT event is a share in a company or an interest in a trust, four additional requirements must be met. These are set out below.

The additional conditions for the sale of shares in companies or interests in trusts were amended significantly with effect from 8 February 2018. In the 2017 Federal Budget, the Government announced that it would amend the Concessions “*to ensure that the concessions can only be accessed in relation to assets used in a small business or ownership interests in a small business*”.<sup>20</sup> In particular, the Government was concerned that some taxpayers were able to access the Concessions for assets which were unrelated to their small business, for instance through arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the Concessions.

#### First extra requirement: modified active asset test using look through approach

The first extra requirement is that the ownership interest must satisfy a modified active asset test, applied based on certain assumptions which effectively implement a ‘look through’ approach.

This requirement is intended to prevent the Concessions from being available for the sale of ownership interests in business entities where most of the value of the assets of the business entity is unrelated to its business activities. In such circumstances, most of the value of the ownership interest sold by the taxpayer is not attributable to a small business and it is considered inappropriate for the Concessions to apply.

#### *First assumption: ignore ownership interests in subsidiary entities and look through to underlying assets*

The first assumption is that ownership interests that the business entity holds in other subsidiary entities are excluded from the 80% active asset calculation. Instead, the calculation adopts a ‘look through’ approach to the underlying assets of the subsidiary entity. This approach treats the market value for the business entity of an asset held by the subsidiary entity as being equal to the asset’s market value multiplied by the business entity’s small business participation percentage in the subsidiary entity.

The calculation treats the business entity's total assets as including all the assets of the subsidiary entity (other than ownership interests in other entities).

However, strict requirements must be satisfied before the business entity can treat the active assets, cash, and financial instruments of the subsidiary entity as its own active assets. The requirements are as follows:

1. the first is that the taxpayer's small business participation percentage in the subsidiary entity must be at least 20% or the taxpayer must be a CGT concession stakeholder in the subsidiary entity; and
2. the second is that the subsidiary entity must be a CGT SBE or satisfy the MNAV Test, again based on certain assumptions. The assumptions are that the only assets or income considered are those of:
  - the subsidiary entity;
  - individuals or companies who can be expected to act in accordance with the subsidiary entity's wishes, or in concert with the subsidiary entity, other than because of a business relationship; and
  - controlled entities in which the subsidiary entity owns at least 20% of the income, capital or voting rights. This means that controllers of the subsidiary entity are disregarded for the purposes of the test.

*Second assumption: disregard cash/financial assets acquired to satisfy test*

The second assumption is that cash and financial instruments inherently connected with the business entity's business are disregarded if they were acquired to ensure that the business entity satisfies the active asset test. This is an integrity rule to ensure that there is no incentive for taxpayers to engage in artificial arrangements to allow entities to satisfy the test.

Second extra requirement: taxpayer with assets greater than \$6m must carry on business

The second extra requirement is that if the taxpayer does not satisfy the MNAV Test, the taxpayer must be carrying on a business just before the sale. The former rules simply required the taxpayer to carry on a business in the year in which the sale occurred.

The requirement is intended to ensure that taxpayers who rely on being a CGT SBE entity to access the Concessions are not able to benefit where the business activities are too remote to justify the taxpayer receiving the benefit of the concessions.

The requirement does not apply if the taxpayer satisfies the MNAV Test. This is because their eligibility is justified by the value of their assets and not by their small business activities.

Third extra requirement: business entity must have less than \$2m income or \$6m net assets

The third extra requirement is that the relevant business entity must either be a CGT SBE or satisfy the MNAV Test, applied based on certain assumptions.

The assumptions are that the only assets or income considered are those of:

1. the relevant business entity;



2. individuals or companies who can be expected to act in accordance with the business entity's wishes, or in concert with the business entity, other than because of a business relationship; and
3. controlled entities in which the business entity owns at least 20% of the income, capital or voting rights. This means that controllers of the business entity are disregarded for the purposes of the test.

The intention of this requirement is to prevent the Concessions from being available for the sale of ownership interests in business entities that are not small businesses.

Fourth extra requirement: business entity must have less than \$2m income or \$6m net assets

The fourth added requirement is that just before the CGT event, either:

1. you are a CGT concession stakeholder; or
2. CGT concession stakeholders in the company or trust together have a 'small business participation percentage in you of at least 90%.

Only individuals can be CGT concession stakeholders.

### What are the Concessions?

Where a taxpayer is eligible for the Concessions, they may access the following concessions. There are four Concessions, each with their own respective conditions.

1. The small business 15-year exemption in Subdivision 152-B (**152-B Exemption**)
  - A company or trust<sup>56</sup> can disregard a capital gain provided:
    - it has **continuously owned** the CGT asset for the 15-year period ending just before the CGT event;
    - it had a "significant individual" for a total of at least 15 years (even if the 15 years was not continuous and it was not always the same significant individual) during which the company or trust owned the CGT asset;
    - just before the CGT event the "significant individual" was over the age of 55 years; and
    - the CGT event happened **in connection with** the "significant individual's" **retirement**, and
  - a significant individual of a company is a person who owns shares in the company that entitles them to at least 20% of the voting power, at least 20% of dividends or at least 20% of any distributions of capital (or if the amounts are different, the lower of the three);
  - a significant individual of a trust is a person who receives at least 20% of the trust's annual distributions of income or capital (or if the amounts are different, the lower of the two);
  - the "in connection with retirement" requirement is not statutorily defined. Based on a plain and ordinary meaning, "retirement" contemplates a reduction of workforce participation, a withdrawal, or a change of behaviour; and

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<sup>56</sup> The rules are similar for individuals.

- the Subdivision 152-B Exemption is generally administered flexibly by the ATO. As per the ATO's non-binding website guidance:<sup>57</sup>

A CGT event happening in connection with an individual's retirement depends on the circumstances of each case. There would need to be at least a significant reduction in the number of hours the individual works or a significant change in their present activities to be regarded as a retirement. The timing may precede or proceed actual retirement.

If the 152-B Exemption does not apply, then one or more of the following concessions can apply to reduce the capital gain:

## 2. The 50% active asset reduction in Subdivision 152-C

- This allows a taxpayer to reduce a capital gain (after application of the general CGT discount of 50%) by a further 50% (potentially reducing a capital gain by up to 75%).
- Taxpayers can choose not to apply the 152-C Concession and instead apply the capital gain to the other concessions described below. The choice is made by the way the taxpayer lodges their tax return for the year that the capital gain occurs.

## 3. The retirement exemption in Subdivision 152-D

- This allows the taxpayer to choose to disregard or all part of the capital gain (CGT exempt amount). However, the choice must be made so that an individual's lifetime retirement exemption limit of \$500,000 is not exceeded. In the case of a company or trust it must pay the CGT exempt amount to at least one of its "CGT concession stakeholders."<sup>58</sup> If that CGT concession stakeholder is under 55 the payment must be made into their superannuation fund.
- The tax laws prescribe strict and rigid rules relating to the CGT exempt amount. These requirements include making a written choice, and ensuring the payment is made within certain timeframes.

## 4. The roll-over deferral in Subdivision 152-E

- This allows a taxpayer to defer the tax on the remaining capital gain by at least two years. By the end of two years, they must have either have bought a replacement active asset (typically at least equal to the value of capital gain disregarded under the roll-over) or pay the tax.<sup>59</sup>

<sup>57</sup> <https://www.ato.gov.au/business/income-and-deductions-for-business/concessions,-offsets-and-rebates/small-business-cgt-concessions/small-business-15-year-exemption/>.

<sup>58</sup> These are "significant individuals" of companies and trusts, and their spouses (provided they have a small business participation percentage" in the company or trust at that time greater than zero): see section 152-60 ITAA 1997.

<sup>59</sup> See CGT events J2, J5, and J6 in the ITAA 1997.

## 3. Practical measures to manage tax risk

### 3.1 Risk: not satisfying all the criteria of a provision

In Part 2 we provided a high-level overview of different roll-overs. Prior to undertaking any roll-over consideration should be given to the specific requirements of each. Whilst we have not gone into these details in great length in Part 2 common issues that arise are:

1. percentage or market value requirements: Subdivision 122-A, Subdivision 122-B, Subdivision 124-N, Subdivision 124-M, Division 615;
2. trust vesting requirement: Subdivision 124-N;
3. residency requirements: Subdivision 122-A, Subdivision 122-B, Subdivision 328-G;
4. small business restructures: basic conditions
5. single arrangement: Subdivision 124-M;
6. substantially the same terms: Subdivision 124-M;
7. 'Nothing else' requirement: Subdivision 122-A/B ('only'), Subdivision 124-E, Subdivision 124-F, Subdivision 124-I, Subdivision 124-Q, Division 125, Division 615;
8. restructuring period: Division 125, Division 615;
9. genuine restructure: Subdivision 328-G;
10. ultimate economic ownership: Subdivision 328-G; Division 615; and
11. back-to-back roll-overs.

### 3.2 Risk: overlooking assets not covered by the roll-over

Before considering the roll-over reliefs that are available, it is important to understand that not all assets will fall within Part 3-3. The following are examples of common assets which the roll-over relief may not apply to:

1. collectable or personal use assets;
2. depreciating assets;
3. trading stock and an asset that becomes trading stock of the company just after the disposal or creation event; and
4. interests in copyright.

These assets may be dealt with by other areas of the tax legislation. For example, if there is a Subdivision 122-A or Subdivision 122-B roll-over, Division 40 provides roll-over relief for the disposal of depreciating assets.

### 3.3 Risk: forgetting about other taxes

When restructuring a business and focusing on the complexities of the federal tax CGT provisions it is easy to overlook state tax or goods and services (**GST**) tax liabilities that may be potentially triggered.

If the business operates in certain jurisdictions, for example Queensland, or there are real property assets involved, a restructure needs to consider the duty provisions in the relevant jurisdiction(s). Just because a CGT roll-over is available, it does not mean that a roll-over is available for duty. The rules are complex and vary between the States and Territories.

Similarly with GST, is the restructure a taxable supply or is GST-free treatment available? For example, for the supply of a going concern.

### 3.4 Risk: insufficient documentary evidence

Most tax cases turn on their facts and taxpayers have the onus under the *Taxation Administration Act 1953* to prove those facts. If the factual analysis is insufficient, or 'facts' are merely assertions then the taxpayer is unlikely to successfully resolve a review, audit, or objection. As Justice Gordon has said:<sup>60</sup>

'Tax cases are based on facts. Ensure you have identified and can prove the "taxable fact" ... The process of identification of the taxable facts is therefore essential. If it is addressed, at the outset, the involvement of the court may not be necessary. Without the proper identification of the taxable facts and a proper assessment of whether you can prove those taxable facts, the process of applying a statute to the facts will inevitably lead to the wrong result. Why? Because you do not have the facts!'

That is, the facts of a case are determined at the time of a transaction and the evidence maintained at the time of the transaction and not by subsequent tax technical analysis. When taxpayers and their advisers pay proper regard to the implementation of transactions, they have the unique ability to control what the relevant facts of that transaction are.

It is also often overlooked at the time of planning and executing a transaction that as taxpayers bear the burden of proof, any lack of evidence operates to the detriment of the taxpayer and not the ATO.

Managing implementation risk involves:

1. ensuring transactions are implemented correctly and documented;
2. taxpayers should consider and document their evidence (beyond journal entries) at the time of the transaction and not at the audit stage (or later); and
3. maintaining records of the key commercial drivers and purpose of the transaction and the evidence that demonstrates those drivers and purpose.

While implementation as evidence can involve added costs at the time of a transaction, those costs are a form of audit insurance invested in the transaction.

Implementation as evidence includes:

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<sup>60</sup> The Hon. Justice Gordon, 'Trends in tax advice and litigation – what to do when it all turns on a word or two' (2009) 38, Australian Tax Review 202, 222.

1. ensuring all the technical requirements of the concessions are met and documenting why;
2. where rules depend on purpose, judgment, or matters of intention, prepare contemporaneous memorandums documenting those concepts and the key commercial drivers of the transaction and its structure;
3. obtaining independent valuations;
4. document the transactions beyond the mere recording of journal entries (that is, prepare minutes, resolutions, deeds etc); and
5. obtaining professional written taxation advice around the concessions and any restructuring pre, or post, the transaction. Preferably this advice should not be by the taxpayer's regular tax agent and, where there are restructuring steps to meet the requirements of the concessions, the advice should consider the application of Part IVA and other anti-avoidance rules.

Consideration should also be given to whether some form of early engagement with the ATO should form part of the planning of the transaction.

## 4. Hart v FCT: a cautionary tale

To enable taxpayers to move from existing structures into desired structures whether that be for the ongoing management of the business or for sale a single roll-over may not always work. The taxpayers may be required to undertake multiple roll-overs. However, such back-to-back roll-overs are complex and can result in unintended tax consequences.

This issue was addressed by the Board of Taxation in its 2017 report to the Treasurer titled “[Report Introducing an Asset Merger Roll Over Relief](#)”. At page 12 the report notes:

Current roll-over relief is a patchwork with each roll-over introduced in isolation in order to address a specific and tightly constrained circumstance...In some limited circumstances, where assets are held via a company, it is currently possible to facilitate a tax-deferred merger outcome using scrip for scrip roll-over. However, access to scrip for scrip roll-over may require the attempted utilisation of another roll-over beforehand to first restructure the business so as to be in a commercially sensible position to secure access to scrip for scrip roll-over, resulting in additional complexity and, in some cases, stamp duty issues.

These comments by the Board of Taxation emphasise the difficulty of roll-overs and the requirement in some circumstances for multiple roll-overs to be undertaken. The case of [Hart v FCT \[2019\] FCAFC 179 \(Hart’s Case\)](#) highlights the complexity of back-to-back roll-overs and a significant tax trap they may trigger – the denial of the 50% CGT discount contained in Subdivision 115-A.

### 4.1 Background to Hart’s Case

Hart’s Case involved the following taxpayers - Mrs Anna Paule, Mrs Cornelia Paule, Mr Terry Paule and Mr Spiro Paule (together, the Paules) and Mr Philip Hart. The Paule’s were beneficiaries of S&TP Trust, Terry a beneficiary of STP Trust, and Spiro a beneficiary of SP Trust. Mr Hart was a beneficiary of the Grosvenor Trust.

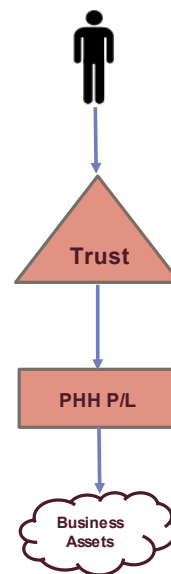
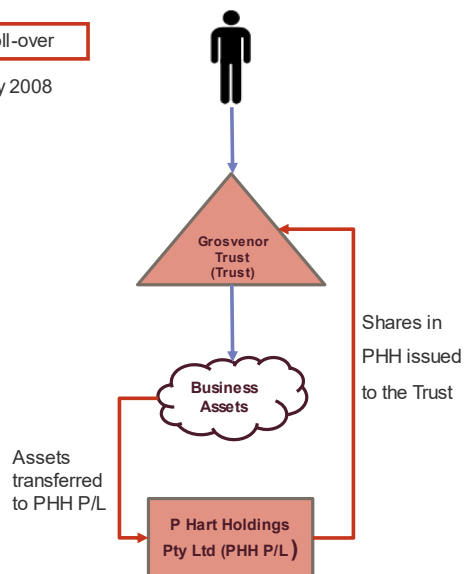
Through a series of roll-overs, one undertaken pursuant to Subdivision 124-N and two in accordance with Subdivision 124-M, that occurred 14 January 2008 and 15 January 2018 respectively, the Paule’s trusts exchanged units they held in various trusts for shares in a company called Findex Pty Ltd (**Findex**).

Mr Hart also undertook roll-overs on the same days with his interest, one pursuant to Subdivision 122-A and two in accordance with Subdivision 124-M until business assets held directly by the Grosvenor Trust became shares in Findex.

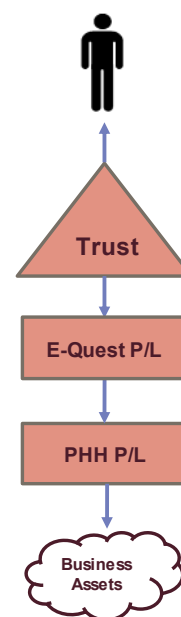
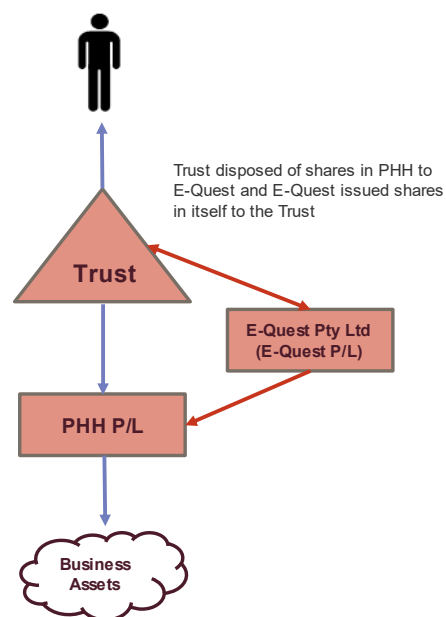
Three days after the roll-overs, on 18 January 2008, all parties sold their shares in Findex to a third party. The taxpayers claimed the CGT discount contained in Subdivision 115-A in respect of this disposal on the basis that the assets had been held for longer than 12 months.

For illustrative purposes, we outline this series of events in relation to Mr Hart:

**122-A Roll-over**  
14 January 2008

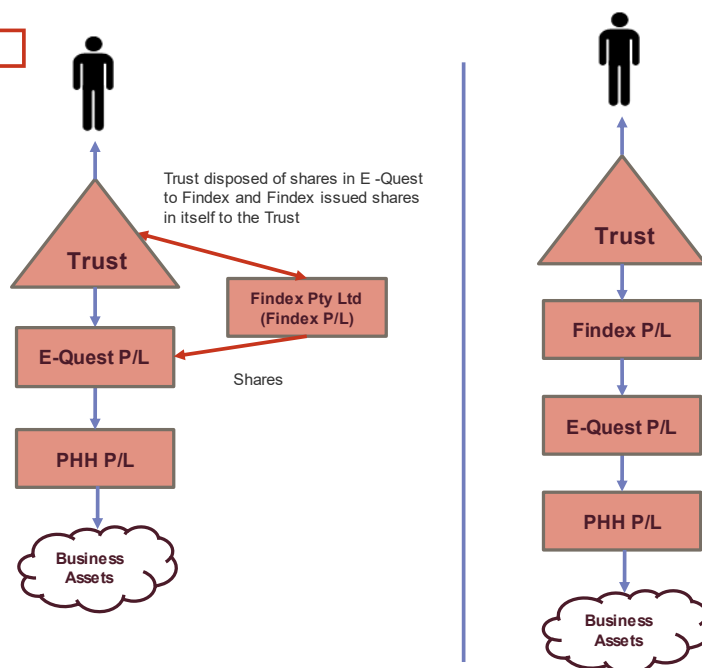


**124-M Roll-over**  
15 January 2008



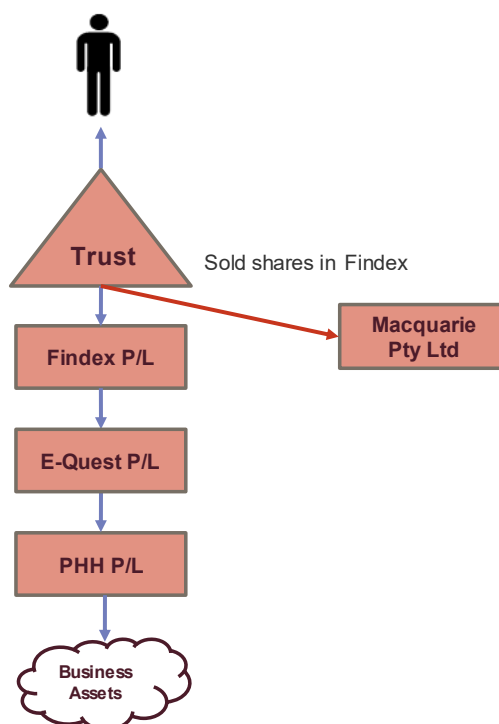
### Second 124-M Roll-over

15 January 2008



### Sale to Third Party

18 January 2008



## 4.2 Key legal issue

The issue in Hart's Case fell on the key requirement of the CGT discount contained in Subdivision 115A being whether the shares in Index had been held for at least 12 months prior to their disposal.

Section 115-25 states:

- (1) To be a \*discount capital gain, the \*capital gain must result from a \*CGT event happening to a \*CGT asset that was \*acquired by the entity making the capital gain **at least 12 months before the CGT event.**



Note 1: Even if the capital gain results from a CGT event happening at least a year after the CGT asset was acquired, the gain may not be a discount capital gain, depending on the cause of the CGT event (see section 115-40) and the nature of the asset (see sections 115-45 and 115-50).

**Note 2: Section 115-30 or 115-34 may affect the time when the entity is treated as having acquired the CGT asset.**

[Emphasis added]

The shares in Findex were not held by the Paule's or Mr Hart for 12 months prior to their disposal on 18 January 2008 but had been acquired three days earlier. Therefore, in the first instance the eligibility for the discount is not met.

As emphasised in the extract above Note 2 directs that sections 115-30 and 115-34 should be considered as they may affect the time a taxpayer is deemed to have acquired a CGT asset.

We turn first to section 115-30. Section 115-30 contains special rules about the time of acquisition and may treat an entity as acquiring a CGT asset earlier. Subsection 115-30(1) contains a table and at Item 1 of this table it refers to CGT assets acquired via the same asset roll-overs. Item 2 refers to CGT assets acquired via replacement asset roll-overs, such as Subdivisions 122-A and 124-M roll-overs.

The Findex shares disposed of by Mr Hart and the Paule's were CGT assets acquired via the Subdivision 124-M roll-over and therefore are within Item 2. Item 2 of section 115-30 states:

A \* CGT asset that the acquirer acquired as a replacement asset for a replacement-asset roll-over (other than a rollover covered by paragraph 115-34(1)(c))

- (a) when the acquirer acquired the original asset involved in the roll-over; or
- (b) if the acquirer acquired the replacement asset for a roll-over that was the last in an unbroken series of replacement-asset roll-overs (other than roll-overs covered by paragraph 115-34(1)(c))-when the acquirer acquired the original asset involved in the first roll-over in the series

...

Ordinarily, paragraph 115-34(1)(c) works to deem a share to have been acquired at least 12 months before the CGT event where the share had been acquired pursuant to a Subdivision 122-A, 122-B, or 124-N roll-over. However, the shares in Findex were acquired via a Subdivision 124-M replacement-asset roll-over not mentioned in paragraph 115-34(1)(c). For the taxpayers in Hart's Case, section 115-30 did not deem the Findex shares to be acquired earlier than the three days prior.

As the taxpayers acquired the Findex shares via a Subdivision 124-M replacement-asset roll-over, Item 2 in section 115-30 (above) applied with the time of acquisition depending on paragraphs (a) and (b) of Item 2. Under paragraph (a), the "original asset" was the share acquired under the first 124-M roll-over, which was three days before, on 15 January 2008.

In relation to (b), the Court found that an unbroken series of replacement-asset roll-overs had occurred. However, Item 2 did not apply to deem an earlier acquisition date as the series included Subdivision 122-A in Mr Hart's case and 124-N roll-over in the Paule's case covered by paragraph 115-34(1)(c). Therefore again, the date of acquisition was 15 January 2008. That is, under both (a)

and (b) of Item 2 of section 115-30, section 115-25 was not satisfied as the taxpayers did not acquire the Findex shares at least 12 months earlier than the date of disposal.

It is noted that section 115-30 was retrospectively amended in 2010, after these transactions occurred in 2008. As part of the 2010 amendments sections 115-32 and 115-34 were included. Therefore, whilst at the time of the transactions this law did not exist, it was applied retrospectively to capture these transactions.

### 4.3 An unpalatable decision?

The taxpayers submitted that the provisions could be interpreted in more than one way and therefore the construction should be determined with reference to the legislative history and intended effect of the 2010 amendments to section 115-30. Indeed, when considering the context of the 2010 amendments and the Explanatory Memorandum to those amendments, there seemed a clear inconsistency.

There seem to be no clear policy reasons for excluding a scenario where there is a roll-over pursuant to Subdivision 124-N (or 122-A), followed by two roll-overs undertaken in accordance with Subdivision 124-M. Through a series of roll-overs, the taxpayers held, in economic substance, the same asset. However, the legal form was different.

The primary judge in [Paule v FCT \[2019\] FCA 394](#) acknowledged this and stated at paragraph 6 that the result was “*unpalatable*” and seemed at odds with the underlying policy of the legislation. However, the Full Federal Court in Hart’s Case said at paragraph 123 that given the complexity of the provisions “*it is difficult to assess whether the result is contrary to the underlying policy of the provisions*” and the technical requirements are such that there “*may be practical outcomes that appear to be inconsistent or hard to reconcile*”.

Hart’s Case is a cautionary tale of the devil being in the detail when undertaking restructures, particularly where undertaking a series of roll-overs as this may have detrimental effects on a taxpayer’s ability to access the 50% CGT discount.

## 5. Demerger relief and TD 2020/6

As discussed above in Part 2 of this paper for demerger relief to be available to taxpayers there must be a 'demerger' as defined in subsection 125-70(1). The first element of the definition of demerger is that there is a 'restructuring' of the demerger group.

What constitutes the 'restructuring' is pivotal to the demerger relief as it may affect whether the conditions of that relief are satisfied. For example, the 'nothing else' condition in paragraph 125-70(1)(c) dictates that the original owners of the interest must acquire a new interest and nothing else. Where the restructuring period is expanded beyond what is considered by the taxpayer and their advisor as the restructuring period it may be that additional benefits or interests are inadvertently acquired. In such cases demerger relief may be denied.

On 22 July 2020 the Commissioner issued [Taxation Determination 2020/6](#) (TD 2020/6) that outlines the Commissioner's opinion as to what constitutes 'restructuring' for the purpose of a demerger group under subsection 125-70(1). Importantly this ruling was a divergence from the ATO's historical approach to restructuring as it narrows the concept. The determination should be carefully considered by advisors before undertaking a demerger.

### 5.1 What transactions form part of the 'restructuring'?

The object of the demerger provisions is stated in section 125-5 as follows:

The object of this Division is to facilitate the demerging of entities by ensuring that capital gains tax considerations are not an impediment to restructuring a business.

Class rulings have in recent years indicated that the Commissioner is shifting away from this facilitative purpose and taken a much more restrictive interpretation of 'restructuring' for the purpose of demerger relief. The Commissioner confirms this more restrictive approach in paragraph 49 of TD 2020/6 where it states in relation to the purpose noted above:

...Relief is, however, subject to several conditions which qualify this general purpose, making it clear that it only extends to certain kinds of business restructuring.

The Commissioner states in TD 2020/6 that what constitutes a 'restructuring' is not prescriptive but rather is a question of fact. The Commissioner will look at all the facts and circumstances in determining this and may expand or restrict what falls within the 'restructuring'. Somewhat confusingly the Commissioner states the expansion or restriction as follows:

1. All steps under a single plan of reorganisation will usually form part of the restructuring and each should be considered. However, the steps are not solely those which deliver the ownership interest in the demerger entity to the shareholder/unitholder. The steps and transactions that will be considered include transactions before those key steps, even where such additional steps are legally independent of each other, contingent on different events, or may not all occur.<sup>61</sup>

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<sup>61</sup> Paragraphs 2 and 3, TD 2020/6.

2. Conversely, a transaction is not automatically part of the restructuring merely because it is enabled by, or is a result of, the restructuring.<sup>62</sup>
3. The temporal proximity of transactions is relevant but simply because transactions are separated by several months does not automatically exclude them from forming part of the same restructuring.<sup>63</sup> TD 2020/6 does not indicate what time would have any influence on a transaction being disregarded for the purpose of demerger relief.
4. Preparatory steps and transactions do not affect the economic position of the owners and therefore will not automatically cause the taxpayers to fail the conditions in subsections 125-70(1) and (2).<sup>64</sup>

When undertaking any roll-over relief advisors should always consider the evidence. In TD 2020/6 the Commissioner notes that a key piece of evidence in determining what transactions or steps form part of a single plan will be the proposal that is presented to the affected owners of original interests.

TD 2020/6 includes seven examples. We discuss some of these examples below.

## 5.2 Demerger followed by a capital raising

In Examples 1 and 2 of TD 2020/6, the Commissioner looks at a post-separation capital raising.

1. In Example 1, the head company is a listed public company which conducts two distinct businesses. The first head company operates directly and the second through a wholly owned subsidiary.
  - The board of the head company decides that the subsidiary's growth is being limited by the structure and therefore proposes to separate the business.
  - The separation is achieved by way of an in-specie distribution of shares in the subsidiary to the shareholder of the head company and listing the subsidiary (the demerger).
  - It is intended that following the demerger when the subsidiary is listed will undertake capital raising to fund its expansion. This will be open to any willing investor.
  - The position stated in TD 2020/6 is that the capital raising in this circumstance will not form part of the restructuring for the purposes of subsection 125-70(1).
2. In Example 2 the steps taken to demerger are the same as in Example 1 except that the capital raising is not open to any willing investor. The head company specifically excludes certain existing shareholders of the subsidiary. In addition, prior to the demerger the head company entered into an arrangement with an unrelated third party for that party to acquire a significant proportion of the shares issued in the subsidiary for funding purposes.
  - The Commissioner states that in these circumstances, the capital raising is not merely a coincidence with the demerger of the subsidiary. The capital raising is designed to alter the ultimate economic position of the subsidiary. As a result, the Commissioner considered the

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<sup>62</sup> Paragraph 4, TD 2020/6.

<sup>63</sup> Paragraph 9, TD 2020/6.

<sup>64</sup> Paragraphs 8 and 10, TD 2020/6.

capital raising to be part of the restructuring for the purposes of demerger under subsection 125-70(1), resulting in the proportionality requirement not being satisfied.

### 5.3 Demerger followed by sale

Example 3 in TD 2020/6 concerns the head company separating its wholly owned subsidiary by way of an in-specie distribution of shares in the subsidiary to shareholders of the head company. The subsidiary will be listed and an unrelated third party will subsequently take over the head company. The head company and the third party had a sale scheme arrangement prior to the demerger. The takeover proposal was announced prior to the separation and listing of the subsidiary.

The Commissioner considers that the distribution of shares in the subsidiary is a condition precedent to the takeover. As such the sale of the head company in the Commissioner's opinion 'objectively' forms part of the restructuring and the 'nothing else' requirement under subsection 125-70(1)(c) is not satisfied.

Example 4 concerns the same facts save for the discussion in relation to the takeover which was terminated before the demerger and was never resumed. There was no takeover proposal prior to the separation, however the head company received another takeover proposal from an unrelated third party seven months after the demerger.

In these circumstances, the Commissioner's views that the sale of the head company was not planned at the time of the in-specie distribution of shares in the subsidiary. The distribution of shares is not a condition precedent to the takeover. Therefore, the takeover bid is 'legally and commercially independent' of the demerger and does not form part of the restructuring for the purposes of subsection 125-70(1).<sup>65</sup> However, importantly TD 2020/6 fails to express the time period at which a transaction that occurs after the demerger would not be considered to form part of the restructure.

### 5.4 Demerger with a sale facility

Example 5 in TD 2020/6 concerns a head company which decided to separate its wholly-owned subsidiary. The subsidiary will be listed on the ASX immediately after the demerger and non-executive shareholders may choose to use a sale facility to dispose of their shares. The shareholders are not compelled to sell their shares under the sale facility and there is no incentive to do so.

The Commissioner considers that whilst the sale facility itself could be regarded as part of the restructuring the actual use of the sale facility falls outside of the restructuring. The Commissioner takes the following factors into account:

1. the independence of decisions made by shareholders from the restructuring;
2. the broad availability of the sale facility to nearly all shareholders; and
3. the lack of any compulsion or incentive to use the sale facility.<sup>66</sup>

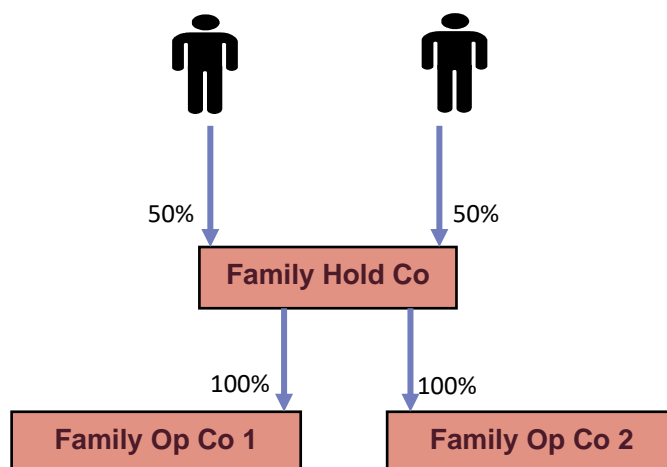
The use of the sale facility does not breach the 'nothing else' requirement in subsection 125-70(1)(c) and the proportionality requirement in subsection 125-70(2).

<sup>65</sup> Paragraph 33, TD 2020/6.

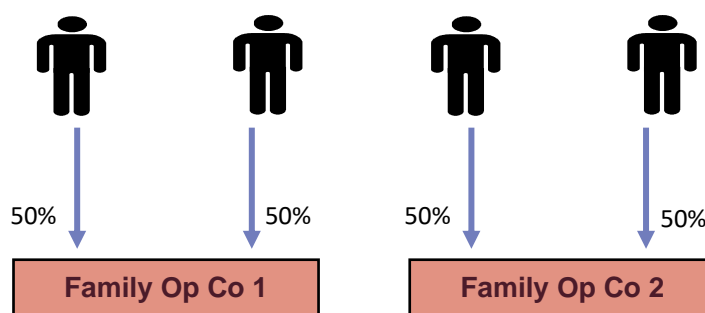
<sup>66</sup> Paragraph 36, TD 2020/6.

## 5.5 Separation by a closely held corporate

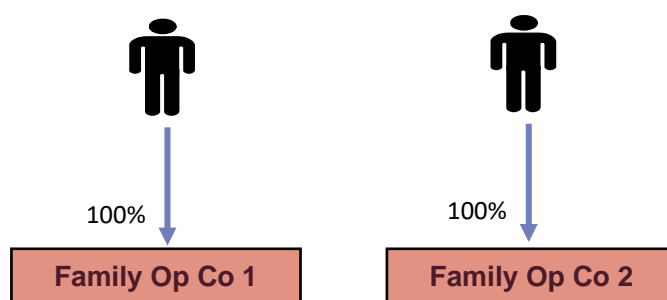
Example 6 of TD 2020/6 concerns two brothers who own Family Hold Co equally but wish to separate the operations and ownership of the business. The initial structure is as follows.



Family Hold Co makes an in-specie distribution to Family Op Co 1 and Family Op Co 2 to the brothers. As a result, Brother 1 and Brother 2 own shares directly in Family Op Co 1 and Family Op Co 2.



In the next step, Brother 1 exchanges his shares in Family Op Co 1 for Brother 2's shares in Family Op Co 2. Brother 1 now owns 100% of Family Op Co 1, and Brother 2 owns 100% of Family Op Co 2.



In the ATO's view the overarching plan of the business reorganisation is to alter the economic ownership of the subsidiaries and the property of Family Hold Co. The exchange of shares in Step 2 therefore forms an essential component of the plan and will be regarded as part of the restructuring. As the brothers acquire something other than the shares distributed by Family Hold Co the 'nothing else' condition in paragraph 125-70(1)(c) is not satisfied.

## 5.6 Preparatory steps and transactions

At paragraph 10 of TD 2020/6 the Commissioner notes that steps or transactions which are included in the scope of a restructuring do not automatically create issues for taxpayers under subsections 125-70(1) and (2). The steps noted are preparatory steps and transactions which do not affect the economic position of the owners of the original interests.

Example 7 TD 2020/6 provides an example of preparatory steps. The example concerns a construction and property development company proposed to separate part of its business, for which it seeks demerger roll-over relief. Prior to the demerger, the company takes steps to prepare for the demerger, including:<sup>67</sup>

1. incorporating a new wholly owned subsidiary;
2. transferring land, cash and other assets to the new subsidiary in return for scrip;
3. substituting the subsidiary as the applicant in various property development applications; and
4. shifting various employees to the subsidiary by novating employment contracts to it.

After the completion of the preparatory steps and transactions, the original company transferred all its shares in the subsidiary to the shareholders of the original company.

The Commissioner states that the preparatory steps and transactions (transfer of assets, shares, novation of contracts etc.) form part of the restructuring of the demerger group. However, given that the preparatory steps do not change the economic position of the owners in the original company, they will not breach the conditions in section 125-70 and prevent the application of demerger roll-over relief. The Commissioner considers that the shareholders of the original company receive 'nothing else' than the shares in the newly incorporated subsidiary.

## 5.7 What does the Commissioner look for?

TD 2020/6 provides guidance on the types of documents the Commissioner takes into consideration when determining the scope of the restructuring.<sup>68</sup>

1. contracts and deeds executed by or affecting the relevant entities;
2. statements in documents filed with regulators;
3. commercial factors;
4. internal deliberations by a company's directors or the directors of a trustee company;
5. statements by directors or influential owners; and
6. announcements to any relevant securities exchange.

The Commissioner highlights the proposal presented to the affected owners of original interests in the head entity of the demerger group is a key factor in determining what transactions form part of the

<sup>67</sup> Paragraph 6, TD 2020/6.

<sup>68</sup> Paragraph 5, TD 2020/6.

reorganisation plan.<sup>69</sup> The ATO's views, as expressed in TD 2020/6, highlight the risks associated with successive or back-to-back CGT roll-overs, and the need to obtain appropriate professional advice before implementing the transaction.

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<sup>69</sup> Paragraph 6, TD 2020/6.



## 6. Back-to-back roll-overs

### 6.1 ATO – advice under development

The ATO develops public advice and guidance to assist taxpayers in applying provisions of the tax legislation to their specific circumstances. In November 2018, the ATO announced that it will develop guidance on back-to-back roll-overs.

The due date for this guidance has been delayed numerous times and currently has no expected completion date. As currently formulated the ATO states:

The ATO is currently looking at arrangements where rollovers are used, including arrangements where rollovers are used in conjunction with another rollover or other transactions, and the public advice and guidance that would be appropriate to provide clarity to the ATO's position on these arrangements. This includes rollovers that have a 'nothing else' requirement.

A (now withdrawn) update to the notice states that TD 2020/6, discussed in Part 5 of this paper, whilst focused on demerger relief identifies ATO views which can be applied more broadly to back-to-back CGT roll-overs.

Paragraphs 2, 3 and 55, and Examples 3 and 4 of Taxation Determination TD 2020/6 Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997? discuss aspects of sequential transactions.

#### 6.1.1 The issue

Sequential or "back-to-back" CGT roll-overs are common in restructuring businesses. However, the ATO has queried whether such back-to-back roll-overs are able to satisfy the 'nothing else' condition present in several roll-overs including:

1. Subdivision 124E: exchange of shares;
2. Subdivision 124F: exchange of rights or options;
3. Subdivision 124I: change of incorporation;
4. Subdivision 124Q: exchange of stapled ownership interests for ownership interests in a unit trust;
5. Division 125: demerger relief; and
6. Division 615: roll-overs applying to assets generally.

The ATO's concern is that the conditions of these CGT roll-overs include the requirement that the entity disposing of their interests receives shares (or units, or an interest etc. as the case may be) and 'nothing else'. However, it was posed by the ATO that where sequential roll-overs occur the taxpayer disposing of their assets receives something else in the form of a right to receive consideration under a subsequent roll-over.

The question is therefore - if the subsequent roll-over is treated as part of the same transaction would the taxpayer be receiving something else and thus fail the requirements of the roll-over relief? The answer, when considering the ATO's recent determination in TD 2020/6 appears to be 'yes'.

## 6.1.2 Inferences from TD 2020/6

What constitutes ‘restructuring’ is a key concept in the context of demergers as it determines what is in the demerger group and thus what can be demerged. This links with the requirement that the shareholders in the demerger group receive shares in the demerged entity and ‘nothing else’. For example, if there is a demerger followed by a scrip-for-scrip roll-over does the restructuring only include the first transaction or both transactions? In a multi-step transaction, there has been concern that the selling entity may receive both (say) a share and a right to receive consideration under the second roll-over.

As discussed in Part 5 of this paper, the Commissioner in TD 2020/6 address the demerger issue. In the determination the Commissioner has outlined its approach to ‘restructuring’. The view is that a series of distinct steps and transactions, even if those transactions are legally independent, can form a single arrangement, plan, or reorganisation. Including or excluding steps in the restructuring may cause the demerger to not satisfy the ‘nothing else’ requirement in the demerger provisions.

The Commissioner has stated that paragraphs 2, 3 and 55 and Examples 3 and 4 of TD 2020/6 discuss aspects of sequential transactions relevant to the consideration of back-to-back roll-overs. In summary:

1. Paragraph 2 notes that “all the steps which occur under a single plan of reorganisation will usually constitute the restructuring.” This means that steps or transactions undertaken as part of a demerger pursuant to Division 125 may be grouped with roll-overs that happen pre or post the demerger.
2. Paragraph 3 continues and states that transactions which occur under “a plan for the reorganisation of the demerger group may constitute parts of the restructuring of the demerger group even though those transactions are legally independent of each other, contingent on different events, or may not all occur.”
3. Paragraph 55 concludes on this point, noting that any previous or subsequent transactions (which infers a roll-over) which occur in sequence form a single plan.
4. In example 3 the Commissioner finds that the nothing else condition in paragraph 125-70(1)(c) will not be satisfied on the sale of a head entity after the separation of a subsidiary from the group because the steps undertaken form one restructure and thus provide the taxpayer with something else.
5. In example 4 the Commissioner has slightly altered the facts such that the transactions appear more distinct and are driven by separate commercial reasons. As a result, the Commissioner finds that the nothing else condition in paragraph 125-70(1) applies.

TD 2020/6 is a clear signal that the Commissioner changed its approach as to what is the scope of a restructuring and is now applying a more literal interpretation of the ‘nothing else’ requirement. It is anticipated that once finalised the guidance on the ‘nothing else’ principle will prevent a number of back-to-back roll-overs accessing roll-over relief where they include a roll-over subject to the ‘nothing else’ requirement.

Clients wishing to undertake back-to-back transactions to rearrange their affairs and/or undertake a demerger carefully consider this considering the potential change in the law. It may be possible to seek early engagement with the ATO as part of that advice, prior to undertaking those transactions.

### 6.1.3 Broader application?

There are other CGT roll-overs where the taxpayer must only include a specific form of consideration. For example, under Subdivision 122-A where an individual or trustee transfers an asset to a wholly owned company CGT roll-over relief is only available if the consideration is “only” shares in the buyer.<sup>70</sup> While drafted differently to the ‘nothing else’ requirement the concepts are similar. At this stage there is no indication that the ATO intends to broaden its scope to prevent back-to-back roll-overs across the board. However, this is an area that advisors should pay careful attention to in case such a change is made.

### 6.1.4 What about Eichmann?

The Full Federal Court in the case of [Eichmann v FCT \[2020\] FCAFC 155](#) (**Eichmann**) considered whether an asset was an active asset for purposes of the small business CGT concessions in Division 152. In finding for the taxpayer, the Court stated:<sup>71</sup>

... in our view the provisions conferring small business relief, being Div. 152 of Pt. 3-3 of the 1997 Act, should be construed beneficially rather than restrictively in order to promote the purpose of the concessions conferred by that Division: c.f. *Collector of Customs v. Cliffs Robe River Iron Associates* [1985] FCA 96; (1985) 7 F.C.R. 271 at 274-275. The beneficial nature of this relief was described in the *Explanatory Memorandum to the New Business Tax System (Capital Gains Tax) Bill 1999* (Cth.) which, when enacted, inserted Div. 152 into the 1997 Act ...

...

It follows that because s. 152-40(1)(a) is beneficial in nature, “its language should be construed so as to give the most complete remedy which is consistent “with the actual language employed” and to which its words “are fairly open””: *Khoury v. Government Insurance Office of New South Wales* [1984] HCA 55; (1984) 165 C.L.R. 622 at 638 per Mason, Brennan, Deane and Dawson JJ. In that respect, a beneficial construction of legislation may, in our view, legitimately influence constructional choices in a given case which arise from the use of generalised language to describe a necessary connection between two things; here those two things are the use of an asset and the carrying on of a business.

...

These inquiries involve issues of fact and degree. But because s. 152-40 should be construed beneficially, no narrow approach to the consideration of these issues should be applied. ...

Could this same ‘beneficial’ approach to back-to-back roll-overs and the “nothing else” requirement? Roll-overs are a concession after all!

The Commissioner issued a [Decision Impact Statement](#) on Eichmann. The Decision Impact Statement did not mention the Full Federal Court’s comments.

<sup>70</sup> Similarly, under Subdivision 122-B.

<sup>71</sup> *Eichmann v FCT* [2020] FCAFC 155 at paragraphs 38, 40, and 41.

## 7. Interactions

The interaction of CGT roll-overs with income tax consolidation and earnouts is complex. We look at aspects of this below.

### 7.1 Interaction with consolidation

Roll-overs can be used to restructure a private group into a consolidatable group. However, the consolidation tax cost setting calculations in Part 3-90 can generate nasty surprises after certain roll-overs. This is best illustrated by way of examples.

#### 7.1.1 Consolidation after a Subdivision 122-A roll-over

The interaction of a roll-over under Subdivision 122-A and the tax consolidation regime does in most cases result in an adverse and anomalous outcome. In most instances, forming a tax consolidated group after a Subdivision 122-A (or B) roll-over will result in a capital gain derived by the head company (**HeadCo**).

OpCo is a successful wholesale business. OpCo is owned by a single individual shareholder - Phoenix. There is only one post-CGT share on issue with a cost base of \$1. The balance sheet of OpCo is as follows:

• Cash	\$500,001
• Debtors	\$500,000
• Stock	\$500,000
• Plant	\$250,000
• Liabilities	\$400,000
• Retained earnings	\$1,350,000
• Share capital	\$1

The sole shareholder - Phoenix - is becoming concerned about the equity represented by the retained profits derived by OpCo. She seeks advice on how to protect the retained profits without causing a tax liability. There are sufficient franking credits to pay a dividend of \$1.35m but Phoenix does not wish to pay “top up” tax.

Phoenix’s advisors suggest that she rolls her share in OpCo into a new holding company using Subdivision 122-A. Immediately after the restructure, Op Co declares a dividend of \$1.35m. To “save on compliance costs”, the advisors recommend forming a tax consolidated group comprising Head Co and OpCo effective from date of the roll-over.

The advisors then prepare the entry allocatable cost amount (**ACA**) calculations on the formation of the consolidated group. These are as follows:

- Step 1: cost base of member interests (\$1)

The roll-over under Subdivision 122-A effectively transfers the cost base of the original shares in OpCo to HeadCo. The original cost base of the shares is \$1. That amount becomes the cost base of the shares in OpCo now owned by HeadCo.

- Step 2: liabilities of OpCo (\$400,000)
- Step 3: undistributed franked profits that have accrued to the group (\$0)

Only profits that have been earned by OpCo since it was owned by HeadCo are included. As we are consolidating immediately, there are no profits to be included in step 3.

- Steps 3A to 7 are not relevant.

The formation ACA is therefore \$400,001. The next step is to allocate the ACA against the retained cost base assets being in this case:

- Cash: \$500,001
- Debtors: \$500,000
- Total: \$1,000,001

As the value of the retained cost base assets (\$1,000,001) exceeds the ACA of \$400,001, then Head Co will derive a capital gain of \$600,000 because of CGT event L3.<sup>72</sup>

In addition, as the ACA has been exhausted on the retained cost base assets, there is no ACA left to allocate towards the tax value of the stock and plant. Therefore, after consolidation, the written down plant for tax purposes is now \$0 and the opening stock value for the HeadCo consolidated group is now also \$0. A loss of \$750,000 in future tax deductions.

A terrible outcome!

Would the outcome have been different if Phoenix's share in OpCo had been pre-CGT?

In [\*Financial Synergy Holdings Pty Ltd v FCT\* \[2016\] FCAFC 31](#) (**Financial Synergy**), pre-CGT units were transferred to the head company for thirty million \$1 shares in the head company. A Subdivision 122-A roll-over applied to disregard any capital gain and preserve the pre-CGT status of the units.

The taxpayer contended that the units had a market value of \$30 million – the market value on the day of the roll-over - for the purposes of the Step 1 ACA calculation rather than \$1.5 million (as contended by the Commissioner, being the original cost pre-1985).

The Full Federal Court in finding for the taxpayer determined that the 'time of acquisition' of the units for the purposes of subsection 110-25(2) was the time when the head company acquired the units. Further, the FFC observed that:

1. the effect of section 122-70 (preserving pre-CGT status) did not extend to the time of acquisition of the shares for the purposes of determining cost base under subsection 110-25(2); and
2. while section 716-855 provided that the cost base of a pre-CGT asset for a recipient under a Subdivision 126-B roll-over was the same as that of the transferor, there was no similar provision in the context of Subdivision 122-A.

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<sup>72</sup> Section 104-510 ITAA 1997.

If Phoenix's share had been pre-CGT, and the approach in Financial Synergy applied, then the ACA would have been \$1,750,000 and:

1. the capital gain under CGT event L3 would not have arisen; and
2. there would not have been a loss of cost base for the plant and stock.

### **7.1.2 Consolidation after a Subdivision 615 roll-over**

As outlined above, forming a consolidated group after a Subdivision 122-A roll-over can result in some terrible outcomes when the cost bases are reset. These outcomes are largely avoided when a Subdivision 615 roll-over is used. This is best explained by reproducing the above example with some minor fact modifications.

OpCo is a trading company owned by Phoenix – 1 post-CGT share – and Xavier – 1 post-CGT share. The financial statements are the same as for OpCo (above) except that:

1. share capital is \$2;
2. cash is \$500,002; and
3. there is internally generated goodwill of \$1,500,000 that is not represented on the balance sheet.

OpCo's advisors recommend a Subdivision 615 roll-over followed by the formation of a consolidated group.

The advisors then prepared the entry ACA calculations on the formation of the consolidated group. These are as follows:

- Step 1: cost base of member interests (\$1,350,002)

Under Subdivision 615, the cost base of the shares in OpCo acquired by HeadCo is the sum of the cost base of the CGT assets of OpCo less its liabilities. This is determined at the time of the roll-over. Based on the above, that would be \$1,350,002.

- Step 2: liabilities of OpCo (\$400,000)
- Step 3: undistributed franked profits that have accrued to the group (\$0)

Only profits that have been earned by OpCo since it was owned by HeadCo are included. As we are consolidating immediately, there are no profits to be included in step 3.

- Steps 3A to 7 are not relevant.

The formation ACA is therefore \$1,750,002. The next step is to allocate the ACA against the retained cost base assets being in this case:

- Cash: \$500,002
- Debtors: \$500,000
- Total: \$1,000,002

There is sufficient ACA to allocate towards the retained cost base assets. Therefore, no gain from CGT event L3 will arise.

The remaining ACA of \$750,000 must then be allocated to reset cost base assets. The ACA is allocated on a proportionate basis against the reset cost base assets based on the market value of the reset cost base assets. The reset cost base assets (and their market values) are:

- Stock \$500,000
- Plant \$250,000
- Goodwill \$1,500,000

The issue that arises is that the remaining ACA of \$750,000 must be allocated to reset cost base assets of \$2,250,000. This results in the cost base of the reset cost base assets becoming:

- Stock \$166,667 (That is,  $\$500,000 / \$2,250,000 \times \$750,000$ )
- Plant \$83,333 (That is,  $\$250,000 / \$2,250,000 \times \$750,000$ )
- Goodwill \$500,000 (That is,  $\$1,500,000 / \$2,250,000 \times \$750,000$ )

What has occurred is that goodwill after the cost setting process has a tax cost base of \$500,000 to the detriment of the tax cost of plant and stock. The effect of this skewing is to reduce future tax deductions for HeadCo in respect of depreciation and cost of sales. Prior to consolidation, this analysis needs to be undertaken to ensure no adverse outcomes.

If the shares in OpCo had been pre-CGT, would it have changed this outcome?

## 7.2 Interaction with earnouts

An 'earnout' is an arrangement where assets of a business are transferred for consideration usually comprised of an upfront payment and additional payments (the 'earnout') based on the economic performance of the assets after completion of the sale. Generally, an earnout arrangement is agreed to by the vendor and the purchaser where there is some conjecture or uncertainty around the exact value of the business or assets being sold. Earnouts can be broken down into:

1. look-through earnout rights; and
2. non-qualifying earnout rights.

### 7.2.1 Look-through earn-out rights

Under section 118-565, a right under an earn-out arrangement will only qualify as a "look-through earn out right" where the following conditions are met:

1. the right is a right to future financial benefits that are not readily ascertainable at the time the right is created; and
2. the right is created under an arrangement that involves the disposal of a CGT asset; and
3. the transaction involves a disposal of a CGT asset which causes CGT Event A1 to happen; and

4. just before the CGT event, the relevant CGT asset was an “active asset” of the entity who disposed the asset; and
5. all the financial benefits that can be provided under the right are to be provided over a period ending no later than 5 years after the end of the income year in which the CGT event happens; and
6. the financial benefits supplied are contingent on the economic performance of the relevant CGT asset(s) or the business for which it is reasonably expected that each of the CGT assets will be an ‘active asset’ during the relevant earnout period; and
7. the value of the financial benefits reasonably relates to such economic performance; and
8. the parties to the arrangement deal with each other at arm’s length in making the arrangement.

The tax treatment of look-through earnouts is as follows:<sup>73</sup>

1. the value of the right is disregarded for the purposes of CGT; and
2. the value of any financial benefits made or received under the rights is included in either the capital proceeds arising from the disposal (for the vendor) or the cost base of the acquisition (for the purchaser).

## 7.2.2 Non-qualifying earn-out rights

Where an earnout arrangement does not qualify as a look-through earnout arrangement (for example, where the earnout period is greater than five years) the Commissioner’s view is that the treatment in (withdrawn) [Draft Taxation Ruling TR 2007/D10](#) should apply. This means that the “separate asset” approach applies to each payment received under the earnout arrangement.

## 7.2.3 Earnouts and Subdivision 124-M roll-overs

As set out in Part 2, where a takeover offer for shares in a target is expressed as a scrip offer or a combination of cash and scrip and a shareholder in the target elects for part cash - “ineligible proceeds” - and part scrip in acquirer, there may be a partial roll-over under Subdivision 124-M to the extent to which the shareholder elects to take scrip rather than cash.

In this case, the roll-over is only partly available for the shares and a capital gain would arise to the extent of the ineligible proceeds.

Where there has been an earnout – a look-through earnout right or non-qualifying earnout right – issues can arise with the interaction with Subdivision 124-M:

1. the effect of the partial roll-over calculations under Subdivision 124-M for any ineligible proceeds is that the part of the cost base of the original interests taken into account in calculating the gain will keep changing as the ineligible proceeds changes; and
2. for an earnout where the earnout component is denominated in shares, rather than cash, the earnout shares will still be ineligible proceeds, because the asset received under the arrangement is a right to receive an indeterminate number of shares, and not the shares

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<sup>73</sup> Section 116-120 ITAA 1997.



themselves.<sup>74</sup> As such, while the look through provisions may still be able to be utilised, it will be on the basis that there is no roll-over under Subdivision 124-M, and therefore tax will be required to be paid even though cash is not received.

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<sup>74</sup> See [ATO Interpretative Decision ATO ID 2002/100](#).

## 8. Casting the net: anti-avoidance provisions

### 8.1 Part IVA

Part IVA is the general anti-avoidance provision of Australian income tax law. The provisions give the Commissioner the power to cancel a 'tax benefit' that has been obtained, or would, but for Part IVA, be obtained, by a taxpayer in connection with a scheme.<sup>75</sup> Generally, Part IVA will apply where:

1. a scheme is entered into or carried out;<sup>76</sup>
2. the taxpayer obtained or would obtain a tax benefit from the scheme<sup>77</sup> if the Commissioner did or had exercised his power to cancel the tax benefit; and
3. one of the parties to the scheme entered into or carried out the scheme for the purpose of enabling the taxpayer to obtain the tax benefit (the "purpose test").

A 'scheme' is broadly defined and would include the roll-overs undertaken as part of a restructure. As stated by Gummow and Hayne JJ:

'Th[e] definition is very broad. It encompasses not only a series of steps which together can be said to constitute a 'scheme' or a 'plan' but also (by its reference to 'action' in the singular) the taking of but one step.'<sup>78</sup>

The identification of a tax benefit requires consideration of what would have or might reasonably be expected to have happened if the particular scheme had not been entered into or carried out. This involves identifying tax benefits via the 'annihilation' approach or the 'reconstruction' approach. The first approach compares the tax outcomes of the scheme against those of an alternate postulate that removes the scheme. The reconstruction approach compares the tax outcomes of the scheme against alternative postulates involving different arrangements.

When undertaking the reconstruction approach, the income tax consequences of the counterfactual are not considered. Here, a taxpayer will obtain a tax benefit in connection with a scheme if it can be demonstrated that a relevant tax effect would have flowed, as a matter of law, from the application of the ITAA 1997 or ITAA 1936 to the alternative postulate.

Subparagraph 177C(2)(a)(i) excludes those tax benefits which are attributable to the making of an agreement, choice, declaration, election, selection choice, notice or option which is expressly provided for. The exclusion, however, does not apply if the scheme was entered into for the purpose of creating any circumstances or state of affairs, the existence of which was necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised.

Where the Commissioner identifies that a tax benefit has been attained by the taxpayer, the provisions of Part IVA further require that the "purpose" test is satisfied.<sup>79</sup> This will occur where:

<sup>75</sup> Subsection 177F(1) ITAA 1936.

<sup>76</sup> See section 177A ITAA 1936.

<sup>77</sup> See section 177C ITAA 1936.

<sup>78</sup> [Federal Commissioner of Taxation v. Hart \[2004\] HCA 26](#) at [43].

<sup>79</sup> Section 177D ITAA 1936.

1. the sole purpose of one of the parties entering into or carrying out the scheme was to enable a taxpayer to obtain a tax benefit; or
2. a party had two or more purposes for entering into or carrying out the scheme, but the dominant purpose was to enable a taxpayer to obtain a tax benefit.

If the Commissioner is satisfied that these elements are present here, Part IVA will apply to the scheme and the Commissioner has discretion to cancel either the whole or part of the tax benefit by either including the amount of the relevant tax benefit in the taxpayer's assessable income or by disallowing a deduction to the taxpayer equal to the amount of the tax benefit.

## 8.2 Section 45B

Section 45B is a further general anti-avoidance rule that was introduced to ensure that companies could not use capital streaming and dividend distribution arrangements to distribute profits to its shareholders as preferentially taxed capital, rather than dividends. Section 45B has been amended specifically to address any tax benefit by way of a demerger. Where section 45B applies to a demerger benefit, the benefit itself, or a relevant part of it, is deemed not to be a demerger dividend.

Section 45B will apply where:<sup>80</sup>

1. there is a 'scheme' under which a person is provided with a 'demerger benefit' or a 'capital benefit' by a company; and
2. under that scheme, a taxpayer (the Relevant Taxpayer) obtains a tax benefit; and
3. having regard to the relevant circumstances of the scheme under subsection 45B(8), it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the Relevant Taxpayer to obtain that tax benefit.

Section 45B therefore tests whether the demerger is tax driven, and whether an appropriate mix of capital has been adopted by identifying and weighing the relevant circumstances of the demerger proposal to determine whether the object of delivering a tax-free dividend into the hands of the owners is a more than incidental purpose of the demerger. Where there exists more than one purpose for a demerger, such as to address conflicts between members of a purchasing company, the tax purpose must be incidental and subordinate to the other substantial purposes.

Unlike Part IVA, section 45B has not yet been the subject of any significant judicial consideration and as such, the extent to which section 45B might apply to different scenarios is relatively unclear. However, the ATO has released a fact sheet that provides examples of where section 45B would apply to demergers.<sup>81</sup> In short, these examples demonstrate the Commissioner's weighing-up of factors under subsection 45B(8) to determine whether the purpose of the scheme was to provide a taxpayer with a tax benefit. It follows that section 45B may not apply in circumstances where the demerger is undertaken to:

1. facilitate a rival's acquisition of a distinct business within a business group;

<sup>80</sup> Section 45B ITAA 1936.

<sup>81</sup> See <https://www.ato.gov.au/businesses-and-organisations/assets-and-property/capital-gains-tax-for-business-assets/in-detail/cgt-demergers-relief/examples-of-how-section-45b-of-the-ita-1936-applies-to-demergers>.

2. separate corporate groups with different commercial drivers to enable more flexible financing arrangements, or to separate management of the business;
3. assist in the public listing of one business by separating the assets of business lines;
4. allow distinct businesses to develop independently of each other; and
5. protect the assets of one business from that of another.

It is important to reiterate that the obtaining of a 'tax benefit' must be incidental or subordinate to any of these purposes. This is demonstrated in the ATO's fact sheet, where in many cases the significant factor leaning toward section 45B not applying was that the relevant parties had no intention of disposing of their interests in the demerged entities after the demerger.

### 8.3 Application of anti-avoidance provisions to roll-overs

In the case of roll-overs tax benefits are clearly identifiable – being the deferral of a capital gain or loss. However, subparagraph 177C(2)(a)(i) states that Part IVA does not apply to where the benefit is attributable to the making of a declaration, agreement, election, selection or choice provided for in the tax legislation this will generally not trigger.

The Board of Taxation has eloquently explained the motivation behind restructuring as providing:

...the means through which two or more entities combine their assets for the purpose of creating a combined business which provides access to higher combined profitability or economic benefits. These benefits may arise from economies of scale, joint access to infrastructure, improved efficiency, enhancing international competitiveness, facilitating greater levels of investment or improving the viability of the businesses that otherwise may be at risk of failure.<sup>82</sup>

This statement supports that back-to-back roll-overs are implemented in many cases to minimise the administrative complexity, cost and time surrounding business structures and not for the dominant purpose of enabling the taxpayer to receive a tax benefit. However, whilst a transaction may be entered into based on a rational commercial decision, this does not automatically mean that the dominant purpose test is not satisfied.

Therefore, whilst the general purpose behind restructures is for the better administration of a business or making the business more attractive for sale, Part IVA may find its application. This is particularly the case where the restructure is undertaken to enable taxpayers to reduce a tax liability that would not have been possible pre the roll-over. There are three important considerations that should be a starting base for advisors when considering utilising a CGT roll-over considering both Part IVA and section 45B:

1. is there a commercial reason behind the scheme/transaction?
2. has the restructure provided a benefit that it otherwise would not have had access to?
3. has the taxpayer received something other than what is contemplated roll-over?

ATO interest may be piqued where a roll-over, either a single or multiple, involves:

<sup>82</sup> Board of Taxation, '[Report introducing an asset merger rollover relief](#)' (February 2017), at 1.7.

1. 'conversion' of non-discountable assets to discountable shares / units;
2. a move to a structure with a lower tax rate (for example, 30% to 25%); or
3. step-ups in cost base (for example, on consolidation).

The Commissioner has for many years highlighted its views on the possible application of Part IVA to certain Subdivision 124-M rollovers in [Taxation Ruling TR 2005/19](#). More recently the Commissioner looked to the use of the Subdivision 126-G roll-over by trusts in [Taxpayer Alert TA 2019/2](#) and suggests that even where a taxpayer may qualify for roll-over relief Part IVA may still be used as a mechanism to deny the CGT deferral that would otherwise occur under the roll-over.

As discussed in Part 6 of this paper the Commissioner has concerns about the ability for taxpayers to use back-to-back roll-overs in a manner inconsistent with the underlying policy intention of each roll-over when considered in isolation. For back-to-back CGT roll-overs, the question is ultimately whether the restructuring exercise has been embarked on with one or more steps to enable the relevant taxpayer to be able to make a further choice under the roll-over provisions.

Nevertheless, it is difficult to reconcile the Commissioner's concerns on back-to-back roll-overs with subparagraph 177C(2)(a)(i). However, does the back-to-back roll-over mean that the taxpayer created the circumstance or state of affairs so that the exception to subparagraph 177C(2)(a)(i) applies?

The Commissioner is yet to finalise his position on anti-avoidance provisions and roll-overs and how far the Commissioner intends to stretch the application of the provisions is unknown. For this reason, taxpayers that are restructuring and utilising CGT roll-overs should ensure that there is sufficient evidence to demonstrate the commercial objective of the restructure and its economic substance. This may include documentary evidence such as memorandums, emails, or file notes which point to the commercial objective.

Ultimately the only way for a given taxpayer to achieve certainty in relation to the application of Part IVA and/or section 45B to their restructuring is to obtain a private binding ruling from the Commissioner. Provided the circumstances of the matter do not change the private ruling would bind the Commissioner to the interpretation until the courts place a different interpretation on the application of Part IVA or section 45B to the taxpayer's circumstances. However, for many taxpayers the lengthy process of seeking such a private ruling may not be possible, particularly in the fast-paced mergers and acquisition space where roll-overs are often utilised.

## 9. Conclusion

Restructuring is a necessary part of business and advisors need to carefully consider the range of issues which arise in dealing with them. The restructuring process should always commence with a review of the outcomes that are sought to enable an advisor to determine which CGT roll-over or roll-overs will be the most suitable. Advisors should then carefully consider the various requirements of those roll-overs to ensure that potential traps lurking within the provisions are not triggered.

Practical steps which can be undertaken to address potential risks in the roll-overs include clearly documenting the decisions and actions. Consideration should also go beyond the CGT provisions and to the impact of decisions on non-CGT assets and state tax liabilities.

Restructuring is a balance. Advisors need to determine a path that will meet the client's needs (to the best extent possible) and with changing ATO perceptions it is expected that this balance will continue to become more complex.

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