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Dear Sir

Submission- Exposure Draft Subdivision 328-G

Introduction

We thank you for the opportunity to provide comments in relation to the proposed Subdivision 328-G. The proposed provisions are most welcome as they will provide significant opportunities for SME's to restructure their businesses without adverse tax consequences

Background on Greenoak Advisory

Greenoak Advisory is a specialist tax practice established by Ray Cummings. The practice focuses on tax consulting advice for private businesses and their owners. Ray Cummings has over 30 year's tax experience including 15 years as a tax partner at Pitcher Partners in Melbourne and has advised many clients on business restructures.

Executive Summary

Our key points are:

- Clarification is required on the range of "eligible" transferors and transferees (particularly for transfers to and from discretionary trusts)
- Where a pre CGT asset is transferred, any equity interest in the transferee must also be pre CGT
- The requirement to transfer assets for no consideration is a major flaw as it can lead to double tax situations
- The new and/or multiple business structure requirement is unduly restrictive
- The proposed legislation operates around the concept of an "asset of a business". In our view, this should be extended to include any asset (including the shares/equity in any company or other entity) which would qualify as an active asset for subdivision 152 purposes rather than having to determine if an asset is "asset of a business"

Each of these points has been set out in more detail in the attached Submission.

We would be pleased to elaborate on any of the points set out in this submission and can be contacted via email ray@greenoakadvisory.com.au or on 0417 537 141.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ray Cummings', with a stylized flourish at the end.

Ray Cummings
Principal
Greenoak Advisory Pty Ltd

8 December 2015

Comments on Exposure Draft Legislation Subdivision 328-G

By Greenoak Advisory Pty Ltd

Object of subdivision - Section 328-425

Whilst nothing turns on the point, we are not convinced that the object of the subdivision is to allow flexibility to owners of small business so much as to allow flexibility for the small business entities themselves.

Transferor and transferee - Section 328-430(1)

Section 328-430 (1)(a)(i) requires that both the transferor and the transferee must be a small business entity and also satisfy the maximum net asset value test. In the alternative, the transferor or transferee must be an affiliate or entity connected with such a small business entity.

In this context, we have two points.

- (i) If the transferor or transferee was the small business entity itself, it would be constrained by the maximum net asset value test whereas affiliates or connected entities do not appear to have this requirement. If the intention is that the small business entity together with affiliated and connected entities must all fall below the 2 million turnover and the \$6 million maximum net asset value, the provisions should set this out clearly and specifically rather than relying on cross reference and understanding of division 152 and section 328 given the overwhelming complexity of these provisions.
- (ii) In Section 328-430 (1)(a)(ii) the reference is to “such a small business entity” we are not sure why the word **such** has been included.

Eligible asset – Section 328-430(1)(c)

The proposed legislation operates around the concept of an “asset of a business”. In our view, this should be extended to include any asset (including the shares/equity in any company or other entity) which would qualify as an active asset for subdivision 152 purposes rather than having to determine if an asset is “asset of a business”

Rollover cost - Section 328-430(2)

The reference to rollover cost here is likely to be misleading or misunderstood. We understand that this means what we would refer to as “tax cost”. However, given the rollover requirements at section 328 – 440(1)(d) that **no** consideration is to be provided for the transfer, it may be useful to have a cross reference to these requirements perhaps inserted as a note to section 328-430.

Pre-CGT status – both asset and equity - Section 328-435

As a pre-CGT asset is intended to keep its pre-CGT status to the transferee, there should be corresponding pre CGT status for the equity holding in the transferee. Absent such a provision, the transferee can sell the asset free from capital gains tax but that profit would become taxable upon windup of the transferee entity or payment of a distribution.

In the context of a company, the profit would result in an unfranked dividend to shareholders in the transferee. For a unit trust, CGT Event E4 could apply to the distribution. Presumably these consequences are not intended.

Section 328-435 rollover requirements

Single or multiple assets?

We are not sure why (1)(a) refers to “a CGT asset, or all of the assets” of a business. This is on the one hand is to allow transfer of a single CGT asset the same time required the transfer of all of the assets. This requires clarification.

New type or multiple entities?

Para (c) requires that there be a restructure resulting in either changing the type of the entity through which the business or part of it is operated or alternatively changing the number of entities to which all part of the business is operated. There could be circumstances where neither of these conditions have been met but the rollover concept would appear entirely appropriate for instance, there may be investment assets and business contained within a company structure.

If the business was to be transferred to a new company structure and would not appear that either(c)(i) or (ii) has been met as the type of structure is the same and the business is only being conducted through a single entity.

Similarly, a shareholder could own two businesses in two separate companies where Company B is a subsidiary of Company A. If Company B was transferred to the Company A shareholder there is no change in economic ownership but again, the requirements in para (c) would seem to negate such a transaction.

Either legislation should be amended to allow for the circumstances in the above examples or paragraph (c) should be deleted as it does not appear to add anything to rest of the legislation.

No Consideration – big problem

We have major concerns with the requirement of paragraph (d) that no consideration be provided in relation to any transfers. This will give rise to significant adverse tax consequences on the subsequent sale of assets and potentially create tax liabilities that did not and could not exist but for the rollover.

The problem does not arise on the rollover but because of the required rollover methodology and “emerges” when the asset is eventually sold by the transferee.

Example 1

Company A has paid for an asset at a cost of \$1 million which was funded out of retained earnings.

That asset is transferred to Company B for no consideration. Company B subsequently sells that asset for \$1 million.

The consequences are as follows:

- Company A has a book loss on the transfer to Company B and therefore immediately has wasted franking credits that are attributable to the million dollars retained earnings used to acquire the asset.
- Company B pays no tax on sale of the asset (as the sale price is equal to the cost base) but must record a book profit of \$1 million.
- When these funds are paid out to the shareholder, they constitute an unfranked dividend and the shareholders will pay tax on the \$1 million.
- In effect, a double tax situation has arisen due to the rollover mechanism required under the proposed provisions. This would not occur if Company A and Company B were permitted to transact at a consideration equivalent to the cost base of the asset.

Example 2

In a similar vein, Company A may have been funded with \$1 million worth of equity and used that \$1 million to acquire an asset.

As for example 1, that asset is transferred to Company B and Company B subsequently sells the asset for \$1 million.

The consequences are as follows:

- Company A has shareholders' equity of \$1 million and must book a loss on transfer of the asset to Company B of \$1 million. Accordingly, it has shareholder net tangible assets of zero (being share capital of 1 million and a loss of 1 million on disposal of the asset for no consideration). The proposed provisions reduce the shareholder's cost base of shares in Company A to zero.
- At that stage, the provisions appear to work as they should. However, the problem arises when Company B sells the asset. As for example 1, as it has paid no consideration Company B must book a profit of \$1 million on sale, even though there is no tax liability on the sale. The shareholder in Company B is not permitted to have any cost base for the shares. When the funds are paid to the shareholder in Company B, they will constitute an unfranked dividend. Again, a tax liability has been created on tax-paid monies. This would not occur if Company B was permitted to pay Company A the original cost of the asset.

Section 328-440(3) Family trusts – what is ok and what is not?

This section requires clarification.

It is reasonably clear that an asset can be transferred from one family trust to another family trust.

It also appears that a non-family discretionary trust can transfer an asset to a family trust.

It is not clear that an individual (or entity owned by that person) is able to transfer an asset into a discretionary trust or that an asset can be transferred out of family trust to an individual or other entity controlled by family group.

Example 1:

Assume the Smith family trust has made a family trust election and distributed an asset to a company wholly owned by John Smith.

Presumably (3)(a)(i) applies as the transferor is a family trust. (3)(a)(ii) does not apply as the asset is not included in the property of the family trust but does (c) operate to permit the rollover because John Smith has the ultimate economic ownership of the asset through his ownership in the company

Example 2:

Assume John Smith owns 100% of Smithco Pty Ltd which transfers an asset to the Smith Family Trust. Where the Smith Family Trust has made a family trust election, we assume the provisions allow rollover relief but have been unable to follow the legislative path to that outcome.

Comments on Explanatory Memorandum

Para 1.8 (and para 1.39)

This paragraph infers that a rollover is available for transfer of assets from a company to an individual. The legislation is actually drafted around the concept of the transfer of an asset from one small business entity to another. Presumably the shareholder of the company would be a connected entity. It would likely be more useful to specifically explain that a rollover is available for the transfer of an asset from a company to a shareholder rather than having to get through an understanding of the connected entity provisions.

Para 1.23

This paragraph should clarify that when it refers to the transferee being taken to have acquired an asset for “cost”, that is a reference to tax cost and not book cost because the provisions do not allow payment of any consideration.

Transfer Scenarios

We have attached as an appendix, a matrix of potential transferor and transferee entities. There are no doubt numerous variations on these. We found it extremely difficult to populate this matrix in the sense of determining what would and what would not be permitted rollovers contemplated by the proposed provisions. It might be useful if something like this was contained within the explanatory materials to give people guidance on the more common transfer/restructure scenarios.

Greenoak Advisory Pty Ltd

MELBOURNE

8/12/15

Transferee

Company

Individual

Discretionary Trust (with FTE)

Discretionary Trust
(no FTE)

Unit Trust

Transferor

Company

If same shareholder

If shareholder

If shareholder in family group

No

If shareholder and unitholder the same

Individual

122-A

N/a

If individual in family group

No

If individual owns all units

Discretionary Trust (with FTE)

If shareholder in family group

Yes?

Yes

No

If units owned by member of family group

Discretionary Trust (no FTE)

No

No

Yes

No

No

Unit Trust

If shareholder and unitholder the same

If
unitholder

Yes if unitholders in family group

No

Yes if same unitholders

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