



4 December 2015

Division Head  
Law Design Practice  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sir / Madam

**RE: Small business restructure roll-over**

Thank you for the opportunity to provide comments on the exposure draft legislation relating to the proposed new roll-over relief for small business restructures.

By way of background, the Hayes Knight group of accounting firms provide a significant amount of taxation advice to small and medium business taxpayers throughout Australia. We also provide assistance to a large number of other accounting firms around Australia through the support and training services operated by Knowledge Shop. We are often engaged to assist with the restructure of small businesses.

We wish to make the following comments with respect to the exposure draft legislation.

**1. Turnover test and net asset test**

Proposed section 328-430 of the *Income Tax Assessment Act 1997* (ITAA 1997) appears to suggest that the roll-over can only apply if the parties to the transaction are classified as small business entities and also satisfy the \$6m net asset value test contained in section 152-15 (or they are connected with or affiliates of entities that meet these conditions).

That is, the parties involved in the transaction would need to pass a test based on annual turnover as well as passing a test based on net asset values.

While we understand the desire to limit this particular form of roll-over relief to genuine small business taxpayers, forcing taxpayers to pass both of these tests may give rise to some adverse consequences. These include:

- In many cases it will be necessary for the parties to incur professional fees to determine the market value of their assets and the assets of any connected entities or affiliates. These fees can represent a significant cost to small businesses.
- Disputes often arise in relation to the valuation of assets. For example, a taxpayer seeking to restructure their business may genuinely believe they have passed the \$6m net asset value

test only for the ATO to disagree with this upon review or audit. If the transaction has already occurred then a significant tax liability could be triggered.

We note that taxpayers seeking to access the existing small business CGT concessions contained in Division 152 ITAA 1997 only need to satisfy one of these requirements. For example, if the taxpayer can pass one of the SBE tests (ie, based on having aggregated annual turnover of less than \$2m) then it is not necessary to satisfy the \$6m net asset value test.

As a general observation, it is typically much easier to determine whether an entity has satisfied a turnover test with a reasonable degree of certainty compared with a net asset value test.

We would recommend that the proposed small business restructure roll-over adopts the same approach as the existing small business CGT concessions in Division 152 by requiring entities to pass one of the tests rather than both of the tests to access the roll-over relief.

Alternatively, we would recommend that safe-harbour valuation methodologies be offered to taxpayers for the purpose of providing certainty on the valuation of certain assets (eg, business goodwill) to assist in determining whether they have passed the \$6m net asset value test prior to undertaking the transaction. Without safe-harbour valuation methodologies there is the risk of the ATO disagreeing with the values attributed to the relevant assets and taxpayers may be reluctant to rely on the roll-over provisions without a greater level of certainty as to whether the net asset test can be satisfied.

## **2. No consideration for the transfer of assets**

Proposed section 328-440 states that the roll-over relief is only available if no consideration is provided in relation to the transfer(s). We assume that this would prevent the transferee from assuming any liabilities of the transferor that relate to the assets being transferred. If so, this could cause some problems at a practical and commercial level.

Firstly, some of the assets being transferred may be subject to specific liabilities that are effectively 'attached' to the assets. For example, items of plant and equipment may have been acquired under a chattel mortgage arrangement and the equipment might be used as security for the loan. If the liability cannot be transferred to the transferee in order to access the roll-over relief then this may also prevent the entity from being able to transfer the asset to the new business entity (eg, the lender may not permit the transfer of the asset without new arrangements being made for the associated liability).

Secondly, if a taxpayer is planning to undertake a restructure by transferring their business to a new entity then in many cases it would be preferable to transfer all assets and liabilities relating to the business. In some cases the taxpayer may wish to wind up the existing business entity. Alternatively, if liabilities remain in the previous business entity it may be difficult to fund repayments if the income generating assets have been transferred to another entity.

We would recommend that the requirement that no consideration be provided be relaxed to enable liabilities associated with the relevant assets or the business in general to be assumed by the transferee.

### **3. Access to CGT discount and other concessions**

At a high level it appears that the small business restructure roll-over could be utilised to provide inappropriate access to the CGT discount on sale of assets when the CGT discount would not otherwise have been available.

For example, if a business is currently operated through a company structure, the CGT discount would not be available on disposal of the business assets by that company. However, the company could transfer its assets to another entity (eg, a trust) using the small business restructure roll-over with the trust subsequently disposing of the assets and obtaining access to the CGT discount.

Similar issues arise in relation to the application of the active asset reduction under the existing small business CGT concessions. While a company can apply the active asset reduction, it can be difficult to extract the exempt portion of the capital gain from the company without paying the amount as an unfranked dividend or having the company wound up. As above, the company could potentially transfer its assets to a related trust using the small business restructure roll-over with the trust subsequently disposing of the assets. This could enable the trust to distribute the exempt amount to its beneficiaries in a tax free manner.

A similar strategy could also be used to “refresh” assets under the active asset test. For example, assets that would not currently meet the active asset test under section 152-35 could be transferred to a related entity tax-free, used in a business conducted by that entity for a limited period of time and then sold by the new owner. This could be relevant for assets that are currently used in a business activity but have been rented to unrelated parties for more than half of their ownership period.

It is not clear from the exposure draft legislation whether any restrictions, limitations or anti-avoidance provisions will be implemented to deal with this. We would recommend that further clarity be provided in this area.

One potential way of addressing the issue identified above in relation to the active asset test would be to extend the test period so that it covers the period that the previous owner held the asset in situations where the small business restructure roll-over has been used. Similar provisions exist when applying the main residence exemption to properties that have been transferred under the marriage or relationship breakdown rules in Subdivision 126-A.

### **4. Division 7A and dividend issues**

If assets are currently held by a company and these are transferred to another entity using the small business restructure roll-over then in many cases this would trigger either a deemed dividend under Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936) or a dividend under section 44 because the transferee will not be able to provide market value consideration for the assets in order to access the roll-over.

For example, under section 109C ITAA 1936 a deemed unfranked dividend is triggered if a private company transfers an asset to a shareholder of the company or an associate of a shareholder and the transfer is undertaken for less than arm’s length consideration. Given the broad scope of the definition of “associate” in section 318 there are likely to be many instances where dividends or deemed dividends would be triggered as a result of transferring assets from a company using the small business restructure roll-over.

Similar issues could arise under Subdivision EA of Division 7A if trusts transfer assets to certain related parties and where the trust owes unpaid present entitlements to a corporate beneficiary.

We would recommend introducing a form of dividend / deemed dividend relief to prevent these issues from arising when the CGT roll-over has been utilised, possibly in a similar manner to the relief provided in connection with the demerger roll-over rules. At the very least, the rules should be amended to enable franking credits to be attached to deemed dividends that arise under Division 7A (refer to section 109RC for an example of where this is permitted already).

#### **5. Depreciating assets subject to pooling rules**

While the draft legislation deals with the application of roll-over relief to the transfer of depreciating assets, it is not entirely clear how the rules would operate when the assets being transferred are subject to the small business pooling rules in Subdivision 328-D.

While existing section 328-243 currently provides a form of roll-over relief it does not appear to have been amended to deal specifically with the operation of the proposed small business restructure roll-over rules.

We would recommend that the rules be amended to provide a form of roll-over relief for assets included in a small business general pool (eg, to enable the new business entity to claim the depreciation deductions after the asset has been transferred) or that have been immediately deducted under the simplified depreciation rules for SBEs.

#### **6. Holding period rules**

The draft legislation indicates that section 115-30 will be amended to enable the holding period of the transferor to be taken into account when determining whether the transferee has held the asset for at least 12 months in order to access the CGT discount on disposal. The draft rules also enable CGT assets transferred under the roll-over to retain their pre-CGT status.

However, there does not appear to be anything in the draft rules which provides for a continuation of the holding period of an asset in the context of the small business 15 year exemption. While this is consistent with the current treatment with respect to most existing forms of CGT roll-over relief, we believe that further consideration should be given to allowing the holding period of the transferor to be taken into account by the transferee in determining whether the 15 year ownership period can be met for the purpose of applying the small business 15 year exemption on subsequent disposal of the asset.

#### **7. Ultimate economic ownership**

Proposed section 328-440 ensures that the small business restructure roll-over cannot apply if there has been a change in the ultimate economic ownership of the asset. While this is consistent with the conditions contained within many other forms of CGT roll-over relief that are used in the context of business restructures, there is some uncertainty around how this requirement should be applied in the following circumstances:

- Where one of the entities involved in the transaction is a company that has different share classes;
- Where one of the entities involved in the transaction is a unit trust that has different unit classes; and
- Where one of the entities involved in the transaction has shares or units held by a discretionary trust.

The draft legislation contains some concessional rules dealing with assets held by discretionary trusts and indicates that family trust elections can be used to manage the position. However, it is not clear whether the same treatment would apply to situations where one of the parties to the transaction has shares or units held by a discretionary trust (eg, assets are transferred to a company where some or all of the shares in that company are held by a discretionary trust).

We would recommend that amendments be made to clarify the situation where shares or units are held by a discretionary trust and to enable family trust elections to be used to manage this. We also recommend that amendments be made to clarify the position with respect to companies or trusts that have different classes of shares or units.

We also recommend that the wording of paragraph 1.42 of the explanatory materials be amended to improve its accuracy. This paragraph suggests that when a family trust election has been made then the trust will be administered for the benefit of a specified family group. We do not believe that this is an accurate statement because a trust that has made a family trust election could still distribute income or capital outside the specified family group if this is permitted by the relevant trust instrument. The making a family trust election simply means that a family trust distribution tax liability will be triggered if distributions are made outside the family group.

#### **8. Start date**

The draft legislation states that the roll-over would be available to transfers of assets occurring on or after 1 July 2016. We recommend that the wording of the application provision is amended to provide additional clarity.

For example, for CGT assets that are not trading stock, depreciating assets or taxed on revenue account we assume that the rules are intended to apply when the CGT event occurs on or after 1 July 2016. For depreciating assets, presumably the intention is for the roll-over to be available where the balancing adjustment event occurred on or after 1 July 2016.

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Thank you for your consideration of this submission. Should you have any queries then please do not hesitate to contact me on 02 9221 6666 or at [Michael.Carruthers@hayesknight.com.au](mailto:Michael.Carruthers@hayesknight.com.au).

Yours faithfully



**Michael Carruthers**  
**Tax Director – Knowledge Shop Pty Ltd**  
**On behalf of the Hayes Knight Group**