THE TAX INSTITUTE

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Dear Christine

Proposals Paper: Changes to support the measure to provide greater consistency in the scrip for scrip roll-over and the small business entity provisions

The Tax Institute thanks you for the opportunity to provide this submission to Treasury in response to the Proposals Paper entitled "Changes to support the measure to provide greater consistency in the scrip for scrip roll-over and the small business entity provisions" (**the New Proposals Paper**).

All section references are to the *Income Tax Assessment Act 1997*, unless otherwise stated.

Background

The 2011-12 Budget included an announcement that both the:

- scrip-for-scrip roll-over integrity provisions; and
- the 'connected entity' test relevant to the small business concessions,

would be amended to ensure that they applied appropriately to interests owned by trusts, super funds and life insurance companies (**the Original Proposal**). It is understood that the genesis of this proposal was the decision of the Supreme Court of Victoria (Court of Appeal) in *Commissioner of State Revenue v Landrow Properties Pty Ltd [2010] VSCA 197 (**Landrow**)*, and subsequent stamp duty cases to the same effect, although this is not stated.

Subsequent to that announcement, a 'Proposal Paper' was issued on 27 May 2011, followed by Exposure Draft Legislation on 22 July 2011.

The amendments set out in that Exposure Draft Legislation were broadly as follows:

- the removal of the words 'for their own benefit' from section 124-783, so as to prevent any possible argument that trusts, super funds and life insurance companies could not have a 'significant stake' or a common stake' in a company for the purposes of scrip-for-scrip roll-over relief; and

- removing the need for ownership under the connected entity test of section 328-125 to be 'beneficial' ownership, so as to ensure that trusts, super funds and insurance companies can control other entities (and therefore be 'connected with' those other entities) for the purposes of applying the Capital Gains Tax (**CGT**) small business concessions.

The Government subsequently reiterated its commitment to the implementation of this measure via an announcement in the 2012-13 Budget. Following that announcement, Treasury released the New Proposals Paper.

The purpose of the New Proposals Paper appears to be twofold:

- firstly, to address certain 'interaction issues' raised by the Original Proposal e.g. to ensure that the absolutely entitled beneficiary is treated as the relevant recipient/owner for the purposes of 124-783 and 328-125 (as amended by the Original Proposal), notwithstanding that the trustee is the *legal* owner of the shares. To this extent the New Proposals Paper merely extends the Original Proposal; and we assume that the Government still intends to proceed with the amendments set out in the Exposure Draft (or at least some variation of them);

- secondly, to improve the application of the rules in Division 106 relating to absolutely entitled beneficiaries, security providers, trustees in bankruptcy and companies in liquidation more generally – e.g. by ensuring that they apply in all situations, not just where the trustee etc performs some positive act.

Submission

The Tax Institute has four broad concerns with the proposals:

- the extent to which the Government has explored whether the Original Proposal raises any 'interaction issues' beyond those identified in respect of Division 106;

- whether the Original Proposal needs to be extended to the 'small business participation percentage' (**SBPP**) rules of sections 152-65 to 152-75;

- whether the proposed changes to Division 106 adequately deal with section 124-783; and

- whether the proposed changes to Division 106 raise their own 'interaction issues'.

Each of those concerns is addressed below in further detail.

1. Original Proposal – Other Interaction Issues

The Original Proposal involved a fairly fundamental shift away from 'beneficial ownership' to ownership *simpliciter.* The Tax Institute therefore queries the extent to which the Government has tested whether that shift raises interaction issues beyond Division 106.

For example, consider the 'indirect control rule' of sections 328-125(7) and (8). If the *direct* control rules of sections 328-125(2) to (6) inclusive now focus on ownership, rather than beneficial ownership, does this suggest that interests held by the corporate trustee of a discretionary trust are 'owned' by that trustee (rather than the trust)? The answer to that question is important, as it then determines which entity (trustee or trust) is relevant for the purposes of the *indirect* control rules of sections 325-128(7) and (8), and whether you apply the rules relating to control of companies or trusts in that regard. Presumably, the intention is that the relevant entity is the trustee company *in its capacity as* trustee of the trust, and that the control rules relating to trusts are to be used. But does this need to be clarified?

2. Original Proposal – SBPP rules

We note that all three items of the table in section 152-70(1) make reference to 'equitable interests' or 'beneficially entitled'. Should those references also be changed to address a *Landrow* type argument? It is unclear to us whether the Commissioner is likely to conclude that the example contained after section 152-75(2) is sufficient to overcome such an argument.

3. Division 106 – Interaction with Section 124-783

The New Proposals Paper suggests various changes to Division 106 and section 328-125, but does not appear to contemplate any changes to section 124-783.

The Tax Institute is of the view that the amendments may need to go further in this regard e.g. in the case of absolutely entitled trusts, deeming the beneficiary to be the owner will rectify the perceived problem with section 328-125, but may not necessarily mean that the beneficiary is the party that has *rights to receive* dividends, distributions etc, as required by section 124-783.

4. Division 106 – Other Interactions

The proposed changes to Division 106 potentially impact on the treatment of absolutely entitled beneficiaries, security providers, trustees in bankruptcy and companies in liquidation throughout the CGT provisions. Is the Government satisfied that all potential interactions have been considered?

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Should you wish to discuss any of the above, please do not hesitate to contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

Ken Schurgott
President