EXPOSURE DRAFT

Inserts for

Tax and Superannuation Laws Amendment (2015 Measures No. 4) Bill 2015: CGT treatment of earnout rights

Commencement information		
Column 1	**Column 2**	**Column 3**
Provisions	**Commencement**	**Date/Details**
1.		
2. Schedule #	The day after this Act receives the Royal Assent.	
3.		

Schedule #—CGT treatment of earnout rights

Part 1—Main amendments

Income Tax Assessment Act 1997

1 After section 112-35

Insert:

112-36 Acquisitions of assets involving look-through earnout rights

Consequences for cost base and reduced cost base

(1) If you *acquire a *CGT asset because an entity *disposes of the CGT asset to you, and that disposal causes *CGT event A1 (the ***first CGT event***) to happen:

(a) neither the *cost base nor the *reduced cost base of the CGT asset includes the value of any *look-through earnout right relating to the CGT asset and the acquisition; and

(b) include in the first element of the CGT asset's cost base and reduced cost base any *financial benefit that you provide under such a look-through earnout right; and

(c) reduce the first element of the CGT asset's cost base and reduced cost base by an amount equal to the amount of any financial benefit that you receive under such a look-through earnout right.

Remaking choices affected by the look-through earnout right

(2) Despite section 103-25, you may remake any choice you made under this Part or Part 3-3 for a later *CGT event involving the *CGT asset if:

(a) after the later CGT event, you provide or receive a *financial benefit under such a *look-through earnout right; and

(b) you remake the choice at or before the time you are required to lodge your *income tax return for the income year in which the financial benefit is provided or received.

Amending assessments affected by the look-through earnout right

(3) The Commissioner may amend an assessment of a *tax-related liability at any time until 4 years after such a *look-through earnout right expires if:

(a) an entity provides or receives a *financial benefit under the look-through earnout right; and

(b) the amount of the tax-related liability:

(i) depends on that entity's taxable income for an income year in which a *CGT event, involving the *CGT asset, happens after the first CGT event but before the financial benefit is provided or received; or

(ii) is otherwise affected by that right's character as a look-through earnout right.

The tax-related liability need not be a liability of that entity.

Note: Subparagraph (b)(ii) covers changes to the amount of that tax-related liability that happen directly or indirectly because of subsection (1) or (2).

(4) If at a particular time a right is taken never to have been a *look-through earnout right because of subsection 118-565(2), the Commissioner may amend an assessment of a *tax-related liability for up to 4 years after that time if:

(a) an entity provides or receives a *financial benefit under the right; and

(b) the amount of the tax-related liability:

(i) depends on that entity's taxable income for an income year in which a *CGT event, involving the *CGT asset, happens after the first CGT event but before the financial benefit is provided or received; or

(ii) was otherwise affected by that right's character as a look-through earnout right before subsection 118-565(2) applied.

The tax-related liability need not be a liability of that entity.

Note: Subsection 118-565(2) restricts look-through earnout rights to rights to financial benefits over a period not exceeding 4 years.

(5) If, after providing or receiving a *financial benefit under a right referred to in subsection (3) or (4):

(a) you are dissatisfied with an assessment referred to in that subsection; and

(b) the Commissioner notifies you that the Commissioner has decided under that subsection not to amend your assessment;

you may object against the assessment, to the extent that it does not take account of that right's character (as a *look-through earnout right or not such a right), in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

2 Section 116-25 (at the end of the cell at table item dealing with event A1, column headed "Special rules:")

Add:

If the disposal involves a *look-through earnout right: see section 116-120

3 At the end of Division 116

Add:

116-120 Disposals of assets involving look-through earnout rights

Consequences for capital proceeds

(1) If *CGT event A1 happens because you *dispose of a *CGT asset, your *capital proceeds from the CGT event:

(a) do not include the value of any *look-through earnout right relating to the CGT asset and the disposal; and

(b) are increased by any *financial benefit that you receive under such a look-through earnout right; and

(c) are reduced by any financial benefit that you provide under such a look-through earnout right.

Remaking choices affected by the look-through earnout right

(2) Despite section 103-25, you may remake any choice you made under this Part or Part 3-3 in relation to the *CGT event if:

(a) you provide or receive a *financial benefit under such a *look-through earnout right; and

(b) you remake the choice at or before the time you are required to lodge your *income tax return for the income year in which the financial benefit is provided or received.

Amending assessments affected by the look-through earnout right

(3) The Commissioner may amend an assessment of a *tax-related liability at any time until 4 years after such a *look-through earnout right expires if:

(a) an entity provides or receives a *financial benefit under the look-through earnout right; and

(b) the amount of the tax-related liability:

(i) depends on that entity's taxable income for the income year in which the *CGT event happens; or

(ii) is otherwise affected by that right's character as a look-through earnout right.

The tax-related liability need not be a liability of that entity.

Note: Subparagraph (b)(ii) covers changes to the amount of that tax-related liability that happen directly or indirectly because of subsection (1) or (2).

(4) If at a particular time a right is taken never to have been a *look-through earnout right because of subsection 118-565(2), the Commissioner may amend an assessment of a *tax-related liability for up to 4 years after that time if:

(a) an entity provides or receives a *financial benefit under the right; and

(b) the amount of the tax-related liability:

(i) depends on that entity's taxable income for the income year in which the *CGT event happens; or

(ii) was otherwise affected by that right's character as a look-through earnout right before subsection 118-565(2) applied.

The tax-related liability need not be a liability of that entity.

Note: Subsection 118-565(2) restricts look-through earnout rights to rights to financial benefits over a period not exceeding 4 years.

(5) If, after providing or receiving a *financial benefit under a right referred to in subsection (3) or (4):

(a) you are dissatisfied with an assessment referred to in that subsection; and

(b) the Commissioner notifies you that the Commissioner has decided under that subsection not to amend your assessment;

you may object against the assessment, to the extent that it does not take account of that right's character (as a *look-through earnout right or not such a right), in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

4 At the end of Division 118

Add:

Subdivision 118-I—Look-through earnout rights

Table of sections

118-560 Object
118-565 *Look-through earnout rights*
118-570 Extra way a CGT asset can be an active asset
118-575 Creating and ending look-through earnout rights
118-580 Temporarily disregard capital losses affected by look-through earnout rights

118-560 Object

(1) This Subdivision and its related provisions set out special rules for *look-through earnout rights. The object of these rules is to avoid unnecessary compliance costs and disadvantageous tax outcomes when entities involved in the sale of a business:

(a) cannot agree on the current value of some or all of the business' assets due to uncertainty about the future economic performance of the business; and

(b) resolve this uncertainty by agreeing to potentially provide future additional consideration linked to this performance.

(2) These rules achieve this object by:

(a) disregarding any *capital gain or *capital loss relating to the creation of a *look-through earnout right; and

(b) for the acquirer of the business—treating any *financial benefits provided (or received) under the right as forming part of (or reducing) the cost base or reduced cost base of the business assets; and

(c) for the seller of the business—treating any financial benefits received (or provided) under the right as increasing (or reducing) the capital proceeds for the business assets.

Note: Sections 112-36 and 116-120 are 2 of the more important related provisions that set out these rules.

118-565 *Look-through earnout rights*

(1) A ***look-through earnout right*** is a right for which the following conditions are met:

(a) the right is a right to future *financial benefits that are not reasonably ascertainable at the time the right is created;

(b) the right is created under an *arrangement that involves the *disposal of a *CGT asset; and

(c) the disposal causes *CGT event A1 to happen;

(d) just before the CGT event, the CGT asset was an *active asset of the entity who disposed of the asset;

Note: For an extra way to be an active asset, see section 118-570.

(e) all of the financial benefits that can be provided under the right are to be provided over a period ending not later than 4 years after the CGT event;

(f) those financial benefits are contingent on the economic performance of:

(i) the CGT asset; or

(ii) a business for which it is reasonably expected that the CGT asset will be an active asset for the period to which those financial benefits relate;

(g) the value of those financial benefits reasonably relates to that economic performance; and

(h) the parties to the arrangement deal with each other at *arm's length in making the arrangement.

(2) The condition in paragraph (1)(e) is not met, and is treated as never having been met, for the right if:

(a) the *arrangement includes an option to extend or renew the arrangement; or

(b) the parties to the arrangement vary the arrangement; or

(c) those parties enter into another arrangement over the *CGT asset or a business for which it is reasonably expected that the CGT asset will be an *active asset;

so that a party could, or does, receive *financial benefits under the right (or one or more equivalent rights) over a total period ending more than 4 years after the CGT event.

(3) A ***look-through earnout right*** is a right to receive one or more future *financial benefits that:

(a) are for ending a right to which subsection (1) applies; and

(b) are certain.

Note: This subsection will not apply if the old right ends as described in subsection (2), as subsection (2) causes the old right to be treated as if it had never been a right to which subsection (1) applies.

118-570 Extra way a CGT asset can be an active asset

(1) For the purposes of this Subdivision, treat a *CGT asset as if it were an active asset of an entity at a particular time, if:

(a) the entity owns it at that time; and

(b) it is either a *share in a company that is an Australian resident at that time, or an interest in a trust that is a *resident trust for CGT purposes for the income year in which that time occurs; and

(c) at that time, the entity:

(i) is a *CGT concession stakeholder of the company or trust; or

(ii) if the entity is not an individual—has a *small business participation percentage in the company or trust of at least 20%; and

(d) at that time, the company or trust is carrying on a *business, and has been carrying on a business since the start of the most recent income year ending before that time; and

(e) the assessable income of the company or trust for that most recent income year was greater than nil, and at least 80% of that assessable income was:

(i) from the carrying on of one or more businesses; but

(ii) not *derived (directly or indirectly) from an asset of a kind to which paragraph 152-40(4)(d) or (e) applies.

Note: Paragraphs 152-40(4)(d) and (e) refer to financial instruments and assets used to derive interest, annuities, rent, royalties or foreign exchange gains.

(2) Subsection (1) does not limit section 152-40 (about active assets).

118-575 Creating and ending look-through earnout rights

Disregard a *capital gain or *capital loss you make because:

(a) *CGT event C2 happens in relation to a *look-through earnout right you receive; or

(b) CGT event D1 happens when you create a look-through earnout right in another entity.

118-580 Temporarily disregard capital losses affected by look-through earnout rights

(1) Temporarily disregard a portion of a *capital loss you make from *disposing of a *CGT asset if the capital loss could be reduced by you receiving one or more *financial benefits under a *look-through earnout right relating to the CGT asset and the disposal.

(2) The portion of the *capital loss that is temporarily disregarded is:

(a) if those *financial benefits can never exceed a maximum amount that is certain—so much of the capital loss as is equal to that maximum amount; or

(b) otherwise—all of the capital loss.

Note: When you receive a financial benefit under the look-through earnout right:

(a) you cease to disregard under this section a portion of your loss related to the amount of that financial benefit; and

(b) your capital proceeds for the disposal increase (see paragraph 116-120(1)(b)), causing a reduction in the amount of your loss.

5 Subsection 995-1(1)

Insert:

look-through earnout right has the meaning given by subsection 118-565(1) or (3).

Part 2—Preserving small business concessions

Income Tax Assessment Act 1997

6 Paragraph 104-185(1)(a)

Omit “period (the ***replacement asset period***) starting one year before, and ending 2 years after, the last CGT event in the income year for which you obtain the roll-over”, substitute “*replacement asset period”.

7 Section 104-190 (heading)

Repeal the heading, substitute:

104-190 *Replacement asset period*

8 Before subsection 104-190(1)

Insert:

(1A) If you choose a small business roll-over under Subdivision 152-E for a *CGT event that happens in relation to a *CGT asset in an income year, the ***replacement asset period*** is the period:

- (a) starting one year before the last CGT event in the income year for which you obtain the roll-over; and
- (b) ending at the later of:
  - (i) 2 years after that last CGT event; and
  - (ii) if the first-mentioned CGT event was CGT event A1, which happened because you *disposed of the CGT asset—6 months after the expiration of all *look-through earnout rights relating to the CGT asset and the disposal.

9 Subsections 104-190(1) and (2)

Omit “replacement asset period”, substitute “***replacement asset period***”.

10 Subsections 104-197(1), (3) and (5)

Omit “replacement asset period”, substitute “*replacement asset period”.

11 Paragraph 104-198(1)(a)

Omit "replacement asset period", substitute "* replacement asset period".

12 Subsections 104-198(2) and (4)

Omit "replacement asset period", substitute "*replacement asset period".

13 Paragraph 152-125(1)(b)

Repeal the paragraph, substitute:

(b) the company or trust makes one or more payments relating to the exempt amount to an individual (whether directly or indirectly through one or more interposed entities) before the later of:

(i) 2 years after the relevant *CGT event; and

(ii) if the relevant CGT event was CGT event A1, which happened because the company or trust *disposed of the relevant CGT asset—6 months after the expiration of all *look-through earnout rights relating to that CGT asset and the disposal; and

(c) the individual was a *CGT concession stakeholder of the company or trust just before the relevant CGT event.

14 After subsection 152-305(1A)

Insert:

(1B) For the purposes of (but without limiting) subsection (1A), you are treated as receiving the *capital proceeds in instalments if:

(a) the capital proceeds are from *CGT event A1 happening in relation to the *disposal of the *CGT asset; and

(b) you receive *financial benefits under a *look-through earnout right relating to the CGT asset and the disposal.

15 After subsection 152-325(2)

Insert:

(2A) For the purposes of (but without limiting) subsection (2), the company or trust is treated as receiving the *capital proceeds in instalments if:

(a) the capital proceeds are from *CGT event A1 happening in relation to the *disposal of the *CGT asset; and

(b) the company or trust receives *financial benefits under a *look-through earnout right relating to the CGT asset and the disposal.

16 Paragraph 292-100(4)(b)

Repeal the paragraph, substitute:

(b) the entity makes a payment to you before the later of:

(i) 2 years after the CGT event; and

(ii) if the CGT event was CGT event A1, which happened because the entity *disposed of the relevant *CGT asset—6 months after the expiration of all *look-through earnout rights relating to that CGT asset and the disposal; and

17 Subsection 995-1(1)

Insert:

replacement asset period has the meaning given by section 104-190.

Part 3—Other amendments

Income Tax Assessment Act 1997

18 Paragraph 25-85(2)(a)

Omit “*contingent on the economic performance”, substitute “*contingent on aspects of the economic performance”.

19 Paragraph 230-15(4)(a)

Omit “*contingent on the economic performance”, substitute “*contingent on aspects of the economic performance”.

20 Subsection 230-460(13)

Omit “contingent only on the economic performance”, substitute “only *contingent on aspects of the economic performance”.

21 Subsection 820-930(2) (table item 2)

Omit “*contingent on the economic performance”, substitute “*contingent on aspects of the economic performance”.

22 Subsection 974-75(1) (table item 2)

Omit “*contingent on the economic performance”, substitute “*contingent on aspects of the economic performance”.

23 Paragraph 974-80(2)(a)

Omit “*contingent on the economic performance”, substitute “*contingent on aspects of the economic performance”.

24 Subsection 974-80(2) (example)

Omit “contingent on the economic performance” (wherever occurring), substitute “contingent on aspects of the economic performance”.

25 Section 974-85 (heading)

Repeal the heading, substitute:

974-85 Right or return contingent on aspects of economic performance

26 Subsection 974-85(1)

Repeal the subsection, substitute:

(1) A right, or the amount of a return, is ***contingent on aspects of the economic performance*** of an entity, or a part of the entity's activities, if the right or return is contingent on the economic performance of that entity, or that part of those activities, but not solely because of one of the following*:*

(a) the ability or willingness of an entity to meet the obligation to satisfy the right to the return;

(b) the receipts or turnover of the entity or the turnover generated by those activities.

27 Subsection 974-85(2)

After "contingent, on", insert "aspects of".

28 Paragraph 974-85(4)(c)

Omit "*contingent on the economic performance", substitute "*contingent on aspects of the economic performance".

29 Subsection 974-140(1)

Omit "*contingent on the economic performance", substitute "*contingent on aspects of the economic performance".

30 Subsection 995-1(1) (definition of *contingent on the economic performance*)

Repeal the definition.

31 Subsection 995-1(1)

Insert:

contingent on aspects of the economic performance has the meaning given by section 974-85.

Taxation Administration Act 1953

32 After paragraph 14ZW(1)(aaa)

Insert:

(aaaa) if the taxation objection is made under subsection 112-36(5) or 116-120(5) of the *Income Tax Assessment Act 1997*—60 days after the notice mentioned in paragraph (b) of that subsection is given to the person; or

33 At the end of section 280-100 in Schedule 1

Add:

Liability arising because of a financial benefit under a look-through earnout right

(5) Subsection (1) does not apply if:

(a) you provide or receive a *financial benefit under a *look-through earnout right; and

(b) you request the Commissioner to amend your assessment for an income year (the ***taxing year***) to take account of the financial benefit; and

(c) you make that request at or before the time:

(i) you are required to lodge your *income tax return for the income year in which the financial benefit is provided or received; or

(ii) you would be so required if you were required to lodge an income tax return for that income year; and

(d) as a result of paragraph (a), you are liable to pay an additional amount of income tax for the taxing year.

34 At the end of section 280-102A in Schedule 1

Add:

Liability arising because of a financial benefit under a look-through earnout right

(4) Subsection (1) does not apply if:

(a) you provide or receive a *financial benefit under a *look-through earnout right; and

(b) you request the Commissioner to amend your *excess non-concessional contributions tax assessment for a *financial year to take account of the financial benefit; and

(c) you make that request at or before the time:

(i) you are required to lodge your *income tax return for the income year in which the financial benefit is provided or received; or

(ii) you would be so required if you were required to lodge an income tax return for that income year; and

(d) as a result of paragraph (a), you are liable to pay an additional amount of *excess non-concessional contributions tax for the financial year.

35 At the end of section 280-102B in Schedule 1

Add:

Liability arising because of a financial benefit under a look-through earnout right

(5) Subsection (1) does not apply if:

(a) you provide or receive a *financial benefit under a *look-through earnout right; and

(b) you request the Commissioner to amend your assessment of *Division 293 tax payable in relation to an income year (the ***taxing year***) to take account of the financial benefit; and

(c) you make that request at or before the time:

(i) you are required to lodge your *income tax return for the income year in which the financial benefit is provided or received; or

(ii) you would be so required if you were required to lodge an income tax return for that income year; and

(d) as a result of paragraph (a), you are liable to pay an additional amount of Division 293 tax for the taxing year.

Taxation (Interest on Overpayments and Early Payments) Act 1983

36 After subsection 9(1A)

Insert:

(1B) Subsection (1) does not apply to an overpayment to the extent that the overpayment results from the person providing or receiving a financial benefit (within the meaning of the *Income Tax Assessment Act 1997*) under a look-through earnout right (within the meaning of that Act).

Part 4—Application and transitional provisions

37 Application of amendments

The amendments made by this Schedule apply in relation to look-through earnout rights created on or after 23 April 2015.

38 Transitional—protection for anticipating announcement

(1) Section 170B of the *Income Tax Assessment Act 1936* also applies as if the following additional announcement were listed in the table in subsection (8) of that section:

14	Budget Paper No. 2, Budget Measures 2011-12, Part 1, topic headed “Capital gains tax—look‑through treatment for earnout arrangements”.	11 May 2010

(2) Subsection 170B(3) and paragraph 170B(8)(b) of that Act also apply in relation to that announcement as if references in those provisions to 14 December 2013 were references to 22 April 2015.