
Chapter 1

Strengthening scrip for scrip roll-over, small business and other concessions

Outline of chapter

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that certain integrity rules in the small business concessions and the scrip for scrip roll-over apply to life insurance companies, superannuation funds and trusts in the same way that they apply to other types of entities.

1.2 Schedule # to this Bill also ensures that these integrity rules (and the capital gains tax (CGT) provisions more generally) are applied as if absolutely entitled beneficiaries, bankrupt individuals, companies in liquidation and security providers are the owners of relevant assets. That is, under these provisions, the nominal owners are looked through to the underlying owners of such assets.

1.3 All legislative references in this chapter are to the ITAA 1997 unless otherwise stated.

Context of amendments

1.4 The connected entity test in the small business entity provisions ensures that assets and turnover of related entities are taken into account in determining whether the thresholds for access to the relevant small business concessions have been exceeded.

1.5 The ‘significant’ and ‘common’ stakeholder tests contained in the scrip for scrip roll-over are designed to ensure that an entity that has a sufficiently high level of ownership in both the original and acquiring entity cannot use the roll-over to defer tax indefinitely on the disposal of the underlying assets of the original entity.

1.6 Broadly, the connected entity test and stakeholder tests seek to determine whether an entity controls, or has the potential to control or influence another entity having regard to the interests held in that other entity that carry voting, income and capital rights.

1.7 Currently, these tests apply only if entities hold the relevant interests 'for their own benefit'. It has been argued that this requirement prevents the tests from applying to interests held by life insurance companies, superannuation funds and trusts because these entities do not own these interests for their own benefit, but rather for the benefit of the policy holders, members or beneficiaries.

1.8 As these entities can control or influence other entities by virtue of the interests that they own in those entities, it is appropriate that these tests be based on the legal ownership of interests, rather than on who benefits from those interests.

1.9 However, in determining whether these tests are satisfied, it would be inappropriate to use legal ownership for arrangements involving assets held on trust in respect of which there is an absolutely entitled beneficiary, assets of bankrupt individuals that have vested in their trustee in bankruptcy, assets of a company in liquidation that have vested in the liquidator or assets provided by a person as security. This is because the intention of the CGT provisions is to treat these underlying entities (that is, the absolutely entitled beneficiary, bankrupt individual, company in liquidation or security provider) as the relevant taxpayer in respect of the asset – rather than the entity that legally owns the asset.

1.10 Currently, the CGT provisions treat an act done by an entity that owns an asset in these circumstances as being done by the underlying entity. However, there is uncertainty as to whether that is sufficient for the stakeholder tests to apply to the underlying owner of the relevant interests. This is because simply treating certain acts done by the owner as having been done by the underlying entity may continue to acknowledge the holding entity as the owner of the asset. There is also uncertainty about how these rules extend to the connected entity test, which is located outside the CGT provisions.

Summary of new law

1.11 Schedule # ensures that the small business connected entity test and the scrip for scrip roll-over stakeholder tests apply on the basis of who owns relevant interests in an entity, rather than who benefits from the interests. This ensures that the tests apply to interests owned by life insurance companies, superannuation funds and trusts in the same way that they apply to interests owned by other types of entities.

1.12 Also, for these integrity rules and the CGT provisions more generally, absolutely entitled beneficiaries, bankrupt individuals, companies in liquidation and security providers (underlying entities) are

treated as the owners of relevant assets. This ensures that the underlying entity, rather than the holding entity, is considered in the connected entity and stakeholders tests and, more broadly, that all CGT consequences in respect of those assets rest with the underlying owner, rather than with the holding entity.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The small business connected entity test and the scrip for scrip roll-over stakeholder tests are based on who owns an interest in an entity, rather than who benefits from the interest.	The small business connected entity test and the scrip for scrip roll-over stakeholder tests are arguably based on who benefits from an ownership interest in the entity, rather than who owns the interest.
Absolutely entitled beneficiaries, companies in liquidation and security providers are treated as the owners of certain assets for the purposes of the CGT provisions and the small business connected entity test.	There is uncertainty whether the CGT provisions treat absolutely entitled beneficiaries, companies in liquidation and security providers as the relevant owners of certain assets. These entities are not treated as owning the asset for the purpose of the small business connected entity test.
The provision that treats a bankrupt as the owner of an asset, rather than the trustee in bankruptcy, extends to the small business connected entity test.	The provision that treats a bankrupt as the owner of an asset, rather than the trustee in bankruptcy, is limited to the CGT provisions.
The provision that treats certain acts done by a security holder as being done by the security provider applies to any act done that relates to an asset over which the security holder holds a security, charge or encumbrance.	The provision that treats certain acts done by a security holder as being done by the security provider only applies to acts done 'for the purpose of enforcing or giving effect to a security, charge or encumbrance the entity holds over the asset'.

Detailed explanation of new law

Stakeholder and connected entity tests

1.13 The small business connected entity test in Subdivision 328-C and the scrip for scrip stakeholder tests in section 124-783 seek to

determine whether an entity has the capacity to control or influence another entity by having regard to the ownership of interests in that other entity. Despite this, the tests do not apply if the entity that owns an interest, and thus has control of the entity, does not benefit from the interest.

1.14 These amendments ensure that the connected entity and stakeholder tests apply having regard only to the ownership of relevant interests, rather than to who benefits from the ownership. As a result, the tests apply to interests held by life insurance companies, superannuation funds and trusts in the same way that they apply to other types of entities. *[Schedule #, items 1, 2, 3, 4, 7 and 8, paragraphs 124-783(6)(b) and (c), subsection 124-783(6) (note), subsection 124-783(7), paragraphs 124-783(9)(b) and (c), (10)(a) and (b), 328-125(2)(a) and (b), and 328-125(8)(e)]*

Example 1.1: Scrip for scrip roll-over stakeholder tests

Zhang Superannuation Fund owns shares in Dollars Ltd, which gives Zhang the right to receive 40 per cent of the dividends in Dollars. Dollars merges with Cents Ltd, with the result that Zhang replaces its shares in Dollars with shares in Cents.

These amendments ensure that, in determining whether Zhang has a significant stake in Dollars, it is not necessary to determine who benefits from the dividends paid on Zhang's shares in Dollars. The fact that Zhang has a right to receive 40 per cent of dividends in Dollars means that it has a significant stake in Dollars.

Example 1.2: Small business connected entity test

Gumm Family Trust owns shares in Robinson Ltd. These are ordinary shares that give Gumm full voting rights. Gumm is entitled to receive 40 per cent of the distribution of income by Robinson.

These amendments ensure that, in determining whether Gumm is connected with Robinson, it is not necessary to determine who receives the benefits of Gumm's ownership holding in Robinson. The fact that Gumm has a right to receive 40 per cent of the distribution of income means that it is connected with Robinson.

Absolutely entitled beneficiaries, bankrupt individuals, companies in liquidation and security providers

1.15 The CGT provisions apply on the basis that any act done by a trustee of an absolutely entitled beneficiary, a trustee in bankruptcy, a liquidator or a security holder is treated as if the act was done by the absolutely entitled beneficiary, bankrupt individual, company in liquidation or security provider (the underlying entity) as the case may be. However, there is uncertainty as to whether those provisions are sufficient

to treat the underlying entity as the owner of an asset in applying the amended stakeholder tests that rely on the mere ownership or holding of an asset. That is, there is uncertainty whether passive acts (or things that simply *happen to* the trustee) can be regarded as an act done *by* the trustee. In addition, as the connected entity test is located outside of the CGT provisions, those rules do not apply for the purposes of that test.

1.16 Accordingly, these amendments ensure that absolutely entitled beneficiaries, bankrupt individuals, companies in liquidation and security providers are treated as the owners of an asset for the purpose of the CGT provisions and the connected entity test.

Absolutely entitled beneficiaries

1.17 These amendments ensure that, just after a beneficiary becomes absolutely entitled to an asset of a trust (disregarding any legal disability), the asset is treated as an asset of the absolutely entitled beneficiary (and not an asset of the trustee) for the purpose of the CGT and connected entity provisions. In conjunction with treating any acts done by the trustee as being done by the absolutely entitled beneficiary, this has the effect that everything that happens to, or in respect of, the asset is taken into account in working out any CGT consequences in respect of that asset in the hands of the beneficiary. It also ensures that the connected entity and stakeholder tests in respect of the asset are determined by reference to the beneficiary. [*Schedule #, items 17 and 18, section 106-50 and section 328-105 (note)*]

1.18 These amendments do not disregard the transfer of the asset to the trustee in the same way that the vesting of the asset is ignored in the case of bankrupt individuals, companies in liquidation and security providers - see paragraphs 1.20 to 1.30. Disregarding the transfer of the asset to the trustee may prevent that transfer giving rise to a CGT taxing point in an appropriate case.

Example 1.3: Absolutely entitled beneficiary

Mary owns 50 per cent of the shares in Soil Limited. These are ordinary shares that give Mary full voting rights. Mary transfers these shares into a trust, and therefore CGT event E2 happens.

One year later, Marina becomes absolutely entitled to those shares and, as a consequence, CGT event E5 happens.

For the purposes of the CGT and the connected entity provisions, Marina is treated as the owner of the shares just after she becomes absolutely entitled to those shares.

Following this, Soil merges with Dirt Limited, with the shareholders in Soil exchanging their shares for shares in Dirt. To determine the CGT consequences of this transaction under the scrip for scrip roll-over, Dirt will need to determine whether Marina is a significant or common stakeholder for the arrangement.

Marina is a significant stakeholder for the arrangement because she owned at least 30 per cent of the shares in Soil that carry voting rights before the arrangement and she now owns at least 30 per cent of the shares in Dirt that carry voting rights.

1.19 CGT events E1 and E2 do not happen if a taxpayer creates a trust over an asset or transfers an asset to an existing trust, and they are absolutely entitled to the asset as against the trustee (see the conditions in subsections 104-55(5) and 104-60(5)). Whilst these amendments do not affect the operation of this exception, these cases still benefit from the amendments described in paragraph 1.17 after the beneficiary becomes absolutely entitled to the asset.

Bankrupt individuals

1.20 Section 106-30 provides that for the purpose of the CGT provisions, the vesting of an asset in a trustee in bankruptcy under the *Bankruptcy Act 1966* is ignored. This ensures that the bankrupt individual continues to be treated as the owner of the asset for the purpose of the CGT provisions and consequently all CGT consequences flow to that entity. *[Schedule #, item 15, section 106-30 (example)]*

1.21 The amendments extend the disregarding of the vesting so that the bankrupt individual is treated as the owner of the asset for the purpose of the connected entity test. In conjunction with treating any acts done by the trustee as being done by the bankrupt individual, this ensures that the test is conducted with reference to the bankrupt individual, rather than to the trustee. *[Schedule #, items 12, 13, 14 and 18, subsections 106-30(1) and 106-30(2), and section 328-105 (note)]*

1.22 As the vesting of the asset in the bankrupt trustee is ignored under section 106-30, it is not possible for a CGT event to happen as a result of the vesting. Therefore, these amendments remove the bankruptcy exception to CGT event A1. *[Schedule #, item 11, subsection 104-10(7)]*

Companies in liquidation

1.23 Generally, liquidators control the assets of a company in liquidation because they control the company. However, in some rare cases, the Court may order that the assets of the company vest in a special purpose liquidator.

1.24 Accordingly, these amendments ignore the vesting of the assets in the liquidator, ensuring that for the purposes of the CGT and the connected entity provisions, a company under liquidation continues to be treated as the owner of the asset. In conjunction with treating any acts done by the liquidator as being done by the company, this has the effect that everything that happens to or in respect of that asset is taken into account in working out any CGT consequences in respect of that asset in the hands of the company. They also ensure that the connected entity and stakeholder tests are determined by reference to the company. *[Schedule #, items 16 and 18, section 106-35 and section 328-105 (note)]*

1.25 As the vesting of the asset in the liquidator is ignored under these amendments, it is not possible for a CGT event to happen as a result of the vesting. Therefore, these amendments remove the liquidation exception to CGT event A1. *[Schedule #, item 11, subsection 104-10(7)]*

Example 1.4: Company in liquidation

Debbie Liquidators Pty Ltd has been appointed as a special purpose liquidator for Shandil Limited. All of Shandil's assets vest in Debbie.

As a result of a fire, certain CGT assets of the business are destroyed. These amendments ensure that any CGT consequences associated with the destruction of the assets rest with Shandil, rather than with Debbie.

Security provider

1.26 A security holder may own an asset while some of the rights of ownership remain with the security provider. This may happen, where a vendor retains ownership of an asset to secure payment for that sale from the purchaser. Although the vendor is the legal owner of the asset, it must exercise any voting rights at the direction of the purchaser, and it is the purchaser who is entitled to benefit from the income and capital of the asset.

1.27 Subdivision 106-D applies to acts done only 'for the purpose of enforcing or giving effect to a security, charge or encumbrance the entity holds over the asset'. A security holder may also do acts on behalf of a security provider that are not for this purpose. For example, they may exchange shares in a scrip for scrip transaction as part of a merger of the company that issued the shares held as security. Accordingly, these amendments ensure that any act done in relation to an asset over which an entity holds a security, charge or encumbrance is taken to be done by the security provider. *[Schedule #, item 17, subsection 106-60(3)]*

1.28 These amendments also ignore the vesting of the assets in a security holder, ensuring that, for the purposes of the CGT and connected entity provisions, the security provider is still treated as the owner of the

assets. In conjunction with treating any acts done by the security holder as being done by the security provider, this has the effect that everything that happens to or in respect of that asset is taken into account in working out any CGT consequences in respect of that asset in the hands of the security holder. For the connected entity and stakeholder tests, this ensures that they are determined with reference to the security provider. *[Schedule #, items 17 and 18, subsection 106-60(1) and section 328-105 (note)]*

1.29 Where a security holder ceases to hold a security, charge or encumbrance over an asset, these amendments treat the asset as having vested in the security holder at that time. This ensures a CGT taxing point arises as a result of the vesting, recognising there has been a change in ownership and control of that asset from the security provider to the security holder. *[Schedule #, item 17, subsection 106-60(2)]*

1.30 As the vesting of the asset in the security provider is ignored, no CGT consequences arise when the asset is transferred to the security holder, or redeemed from the security holder as a result of the security arrangement coming to an end. Therefore, these amendments remove the security holder exception to CGT event A1. *[Schedule #, item 11, subsection 104-10(7)]*

Example 1.5: Security provider

Cissie owns shares in Chen Ltd which gives her rights to receive 30 per cent of the voting power and dividends of Chen. Cissie enters into a loan with Boyd Bank and provides her shares in Chen as security.

Chen enters into a scrip for scrip transaction with another entity. Boyd Bank chooses the scrip for scrip roll-over on behalf of Cissie for the capital gains that would otherwise be made.

Although accepting a scrip for scrip transaction is not an active act for the purpose of enforcing a security, these amendments ensure that any act done in relation to the shares is done by Cissie. Cissie is also treated as the owner of the shares for the purposes of the CGT and connected entity provisions.

No CGT consequences arise when the shares are transferred to Boyd Bank or subsequently when the shares are redeemed from the Bank on completion of the security agreement.

Application provisions

1.31 Table 1.1 describes the application provisions that are relevant to the amendments to the small business connected entity and the scrip for scrip roll-over stakeholder tests.

Table 1.1: Application dates — Integrity changes to the connected entity and stakeholder tests

<i>Provision affected</i>	<i>Application date</i>
CGT provisions	CGT events that happen after 7:30 pm on 10 May 2011
Wine equalisation tax	Financial years commencing on or after the commencement of these provisions
Other provisions	The 2011-12 income year and later income years

[Schedule #, items 5 and 9]

Implications for the CGT and other provisions

1.32 The integrity changes that affect the CGT provisions are retrospective to ensure that transactions that have taken place after the announcement are covered by these amendments. This provides certainty for transactions that occur from the time of announcement. *[Schedule #, items 5 and 9]*

1.33 To the extent that provisions are affected other than CGT and the wine equalisation tax regimes, the amendments apply to the 2011-12 and later income years. Items 5 to 12 in the table in section 328-10 list the relevant concessions that this application date affects. This date ensures that taxpayers are not impacted by these changes mid-way through an income year. *[Schedule #, items 5 and 9]*

1.34 It is argued that the law already applies in a way consistent with these amendments. Consistent with that view, some taxpayers have prepared their income tax assessments on a basis consistent with these amendments, having done so based on how they understood the law applied.

1.35 These changes accordingly ensure that the mere fact that has been a change in the wording of the law cannot be used as evidence that there has been a change in the meaning of the law. *[Schedule #, items 6 and 10]*

Implications for the wine equalisation tax provisions

1.36 The connected entity test is used to define an ‘associated producer’ for the purposes of the wine equalisation tax provisions. These rules ensure that a wine producer cannot access an additional amount of wine equalisation tax rebate by dividing their businesses into separate entities.

1.37 Eligibility for the wine equalisation tax debate is based on financial years rather than income years. Applying the start date based on an income year may lead to inappropriate outcomes where the wine producer is eligible for the rebate at the start of a financial year, but because of the amendments, is not eligible at the end of the financial year. Therefore, to avoid this issue and to ensure there are no retrospective impacts on the wine equalisation tax provisions, these changes apply from the first financial year on or after the commencement of the amendments. [Schedule #, item 9, paragraph 9(a)]

Look-through treatment for certain entities

1.38 Table 1.2 describes the application provisions that are relevant to the amendments that provide look-through treatment for certain entities.

Table 1.2: Application dates – Look-through treatment for certain entities

<i>Provision affected</i>	<i>Application date</i>	
	<i>Option of taxpayer</i>	<i>Automatically apply</i>
CGT	CGT events that happen during the 2008-09 income year and later income years	CGT events that happen on or after the commencement of these provisions
WETA 1999	N/A	Financial years commencing on or after the commencement of these provisions.
Other provisions	2008-09 income year and later income years	Income years commencing on or after the commencement of these provisions

[Schedule #, item 19]

1.39 Whilst these look-through changes can be retrospective, they are only so at the option of the taxpayer. Therefore, taxpayers are not disadvantaged by the retrospectivity of these changes.

1.40 To the extent these provisions affect non-CGT provisions, they apply automatically from the first income year (or financial year for wine equalisation tax cases) on or after the day these amendments commence. This ensures taxpayers will not be disadvantaged by these changes mid-way through an income year and may be particularly relevant for provisions under the WETA regime (see paragraphs 1.36 to 1.37).

Amendment of assessments

1.41 The operation of section 170 of the *Income Tax Assessment Act 1936* (which provides time limits for amending assessments) is modified for these amendments if they apply prior to their commencement. Taxpayers can seek an amended assessment to access changes where their amendment period has expired. Broadly, taxpayers are able to seek an amended assessment in these circumstances within two years of these amendments commencing. [*Clause 4*]