



24 August 2011

Paul McCullough
The General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: cgt_beneficialinterests@treasury.gov.au

Dear Paul

July 2011 Exposure Draft – Greater Consistency in the Scrip for Scrip Roll-Over and the Small Business Entity Provisions

The Institute of Chartered Accountants in Australia welcomes the opportunity to comment on the abovementioned Exposure Draft of the legislation (the **Exposure Draft**) and the accompanying explanatory material (the Explanatory Material) released on 22 July 2011. These comments are also made in light of our telephone call with Paul McMahon on Monday 22 August 2011.

The 2011-12 Budget included a measure to provide greater consistency in the application of the scrip for scrip roll-over in the capital gains tax provisions and the small business concessions. This measure, in broad terms, replaces the references to 'beneficial ownership' in these provisions with references to 'ownership' to ensure that the scrip for scrip roll-over and small business concessions apply appropriately to taxpayers.

Small business entity/small business CGT concessions

General comments

The earlier Proposals Paper of May 2011 ('the Paper') stated at paragraph 12 (these comments have been re-stated at paragraph 1.5 of the Explanatory Material) that it:

... has been argued that the beneficial interest requirements prevent the tests from applying to trusts, life insurance companies and superannuation funds because they do not own the interest for their own benefit, but rather for the benefit of their beneficiaries, policy holders or members

As we noted in our submission on the Paper, our members that work extensively with the CGT small business concessions are not aware of any 'abuse' of these concessions in the manner set out in the Paper. On the contrary, in their experience most SME market taxpayers and their advisers are applying the existing provisions on the basis that trusts are the owners of the relevant assets for the purposes of those rules.

GPO Box 9985
in your capital city

Customer Service Centre
1300 137 322

NSW
33 Erskine Street
Sydney NSW 2000
Phone 61 2 9290 1344
Fax 61 2 9262 1512

ACT
L10, 60 Marcus Clarke Street
Canberra ACT 2601
Phone 61 2 6122 6100
Fax 61 2 6122 6122

Qld
L32, 345 Queen Street
Brisbane Qld 4000
Phone 61 7 3233 6500
Fax 61 7 3233 6555

SA / NT
L11, 1 King William Street
Adelaide SA 5000
Phone 61 8 8113 5500
Fax 61 8 8231 1982

Vic / Tas
L3, 600 Bourke Street
Melbourne Vic 3000
Phone 61 3 9641 7400
Fax 61 3 9670 3143

WA
Ground, 28 The Esplanade
Perth WA 6000
Phone 61 8 9420 0400
Fax 61 8 9321 5141

Specific concerns

Paragraph 13 of the Paper (and see paragraph 1.6 of the Explanatory Material) proposed that:

... the connected entity test in the small business entity provisions will be amended so that ... [it] is based on 'legal ownership or the right to acquire legal ownership', regardless of who benefits from that right or ownership.

This proposal has, despite our submission to the contrary, been largely adopted in the Exposure Draft. That is, the Exposure Draft proposes that subsections 328-125(2)(a) and (b) of the *Income Tax Assessment Act 1997* (ITAA 1997) should be amended by omitting:

... 'beneficially own, or have the right to acquire the beneficial' ... [and substituting] 'own, or have the right to acquire the'.

As in the case of our submission on the earlier Paper, we have a number of concerns with this proposal and do not believe that it will make the CGT small business concessions work in the manner in which they are intended to apply.

- *Nominees*

It is not clear to us why a shareholder in a private company who is a nominee for one (or more) of the other shareholders in that company should be treated as a controller of that company for the purposes of the 'connected with' test in section 328-125 of the ITAA 1997.

For example, it is not uncommon for private companies to be formed with at least two equal shareholders - with one or more of those shareholders holding their share(s) as nominee for another party. Under the current provisions, any shareholder holding their share(s) as nominee for another party will not be treated as a controller of the company for the purposes of the CGT small business concessions - which we believe is an entirely appropriate result as they are not the beneficial owner.

- *Assets held as security*

Similarly, it is not uncommon in situations where shares in a company have been sold or put up as security for a loan/other transaction to find that a custodian will hold legal title to those shares pending the completion of the sale/fulfilment of the relevant contractual obligations. Once again, under the current provisions the shareholder holding the share(s) as custodian will not be treated as a controller of the company for the purposes of the CGT small business concessions - which we also believe is an entirely appropriate result.

There are, in fact, a range of commercial circumstances in which one party will hold legal title to assets (such as shares and trust interests) without being the beneficial owner of them - the current "connected with" test in section 328-125 of the ITAA 1997 deals adequately with these cases and we would be concerned with any change which opens up the possibility of a different outcome.

- *No definition of the term 'own' for taxation purposes*

We note that not only is there currently no definition of the term 'own' for taxation purposes but its ordinary meaning may vary from case to case - for example, it may mean equitable ownership, legal ownership or joint ownership.

Accordingly, if it is the intention that the (mere) legal ownership of an asset is sufficient to result in one entity being connected with another entity, we believe that this will need to be made clear in any amendment.



- *Need for 'carve outs'*

If the current proposal is legislated, we foresee that a range of practical and technical issues will arise - not least of which will be the fact that extensive 'carve outs' will be required to ensure that the mere legal ownership of an asset does not automatically result in an entity being connected with a company/trust.

Whilst Subdivisions 106-C and 106-D of the ITAA 1997 will be useful starting points for such 'carve outs', we note that the current wording of section 106-50 may not be broad enough to deal with the joint ownership of assets. That is, consistent with the view of the ATO in *Taxation Ruling* TR 2004/D25, if there is more than one beneficiary of a trust there can never be absolute entitlement (unless the asset are fungible).

Alternative proposal

In order to avoid the need to consider extensive 'carve outs' so that the mere legal ownership of an asset does not give rise to problems in a range of commercial circumstances, we believe that a "for the avoidance of doubt" style amendment should be introduced that deems:

- trusts (other than managed investment trusts);
- life insurance companies; and
- superannuation funds,

to be the beneficial owners of assets for the purposes of the CGT small business concessions.

For example, a subsection 328-125(2A) could be introduced that deemed the above entities to be the beneficial owners of assets for the purposes of subsection 328-125(2).

To the extent that bare trust (style) asset holdings are inappropriately regarded as beneficial ownership under the above change, an amendment could be made to subsection 328-125(6) - which already allows the ATO a discretion to determine that an entity does not control another entity.

In particular, the words "but less than 50%" could be removed from subsection 328-125(6) so that the ATO has a discretion to determine that control does not exist - i.e. regardless of the control percentage that technically exists.

Such an amendment will mean that the provisions can continue to be applied in the manner that most SME market taxpayers and their advisers have been applying them.

Application date for the CGT small business concession amendments

Given that most SME market taxpayers and their advisers have been applying the existing provisions on the basis that trusts are the owners of the relevant assets for the purposes of the connected entity rules, we believe that:

- (at the very least) the Explanatory Memorandum should make it clear that these changes are 'clarifying' amendments which are not designed to alter the application of the existing law; and
- the amendments should apply in relation to: (i) CGT events happening after 7:30 pm on 10 May 2011; and (ii) assessments (including amended assessments) for the 2010/11 and earlier income years issued after 10 May 2011.

We note that unless the application date of the 'clarifying' amendments is retrospective there is a risk to the revenue from taxpayers seeking amended assessments to claim the benefit of the CGT small business concessions for transactions that have occurred over the last four years - i.e. on the basis that they have incorrectly regarded trusts as connected entities which had to be included when determining their eligibility for the CGT small business concessions.



If Treasury is concerned that such a retrospective application date will be regarded as a 'U-turn' that allows the ATO to re-open past assessments, the phrase 'at the choice of the taxpayer' could be added to (ii) above so that it reads:

(ii) at the choice of the taxpayer - assessments (including amended assessments) for the 2010/11 and earlier income years issued after 10 May 2011.

Please do not hesitate to contact Susan Cantamessa on (02) 9290 5625 or Caroline Clarke on (02) 9080 5833 if you need clarification in respect of any of our comments.

Yours sincerely



Yasser El-Ansary
Tax Counsel
The Institute of Chartered Accountants in Australia

