



18 July 2012

Ms Christine Barron
The General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: CGT_BeneficialInterests@treasury.gov.au

Dear Christine

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

The Institute of Chartered Accountants in Australia (the **Institute**) welcomes the opportunity to comment on the abovementioned June 2012 Proposals Paper dealing with a number of proposed amendments announced in the 2012-13 Budget.

GPO Box 9985
in your capital city

References are to the *Income Tax Assessment Act 1997 (ITAA 1997)*.

Customer Service Centre
1300 137 322

Background

The proposed amendments are a result of CGT interaction issues which came to light in designing and consulting on the 2011-12 Budget Measures to ensure:

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33 Erskine Street
Sydney NSW 2000
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Fax 61 2 9262 1512

- the effective operation of the integrity rules in section 328-125 so that trusts are not able to avoid being treated as 'connected with' another entity for the purposes of the small business concessions on the basis that trusts do not own assets for their own benefit and
- the integrity rules in sections 124-782 and 124-783 of the scrip rollover rules that apply to individuals and companies also apply appropriately to trusts, superannuation funds and life insurance companies.

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

The Institute has previously lodged submissions on both the May 2011 Proposal Paper in relation to the 2011-12 measures and the subsequent exposure draft legislation to implement those measures.

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

The proposed 2012-13 Budget measures

The 2012-13 Budget measures aim to ensure that (leaving aside impacts on the wine equalisation rules):

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Adelaide SA 5000
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Fax 61 8 8231 1982

- the provisions concerning absolutely entitled beneficiaries, security providers and companies in liquidation interact appropriately with the CGT provisions and with the connected entity test in the small business entity provisions and
- the bankruptcy rule in section 106-30 also applies to the connected entity test.

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

Proposed amendments to absolute entitlement, security holder and liquidation provisions

In relation to the CGT provisions Section 3 of the Proposals Paper indicates that it is intended that:

- Subdivision 106-C operates to treat a beneficiary that is absolutely entitled to a CGT asset as against the trustee as the owner of the asset for all CGT purposes.
- Subdivision 106-D operates to ensure that:
 - a security provider and not the security holder is treated as the owner of the asset for CGT purposes and
 - the security provider is accountable for CGT in respect of CGT events in relation to the asset and not simply in relation to CGT events resulting from “an act done by an entity ... for the purpose of enforcing or giving effect to a security, charge or encumbrance the entity holds over the asset”. It is proposed that this limitation be removed.
- Section 106-35 operates to ignore the vesting of assets of a company in a liquidator to ensure that the company is treated as the owner of assets for all CGT purposes.

Proposed amendments to the connected entity test

It is proposed that the connected entity test be amended to make clear that assets that are actually owned by a trustee on behalf of an absolutely entitled beneficiary, a security holder, a bankruptcy trustee or a liquidator are treated as being owned respectively by those persons.

Comments

We welcome the proposed amendments and particularly the fact that assets actually owned by a trustee on behalf of absolutely entitled beneficiaries (which should capture beneficiaries of bare trusts in most circumstances) and security providers will be treated as being owned by those persons and not the trustee for the purposes of the small business concessions and the scrip for scrip integrity rules.

However, much will depend on how these proposed amendments are legislated and we look forward to reviewing the draft legislation to implement the proposed changes in due course.

In the meantime, our only comments on the policy design of the proposed amendments are as follows:

- It appears that no change is proposed to section 106-30 (Effect of bankruptcy). That section ignores the vesting of an individual's CGT assets in the trustee under the *Bankruptcy Act 1996* or under a similar foreign law (subsection (1)) and treats acts done in relation to CGT assets by trustees appointed in different circumstances as if they had been done by the individual (subsection (2)).

As we understand it, when the CGT rules were rewritten into the ITAA 1997, it was expressly stated that the vesting of an individual's CGT asset in the trustee was to be ignored to make clear that a taxing point did not arise at that time. The Explanatory Memorandum to *Tax Law Improvement Bill (No. 1) 1998* explains the change as follows:

Change

State expressly that the act of vesting assets in a trustee under a bankruptcy law is ignored for CGT purposes.

Explanation

It is implicit in the 1936 Act that the vesting of assets in a trustee in bankruptcy does not, of itself, have CGT consequences. In the rewritten law, it is expressly stated that any acts of the trustee in relation to vested CGT assets are taken to be the bankrupts acts.

Subsection 104-10(7) was subsequently introduced by *Tax Laws Amendment Act (No 4) 1999* to exclude from CGT event A1 the disposal of assets because of the vesting of the asset in a trustee under the *Bankruptcy Act 1966* or under a similar foreign law, effectively replicating subsection 106-30(1) to avoid doubt. (In addition, subsection 104-10(7) prevents CGT event A1 from applying to the disposal of an asset to provide or redeem a security or because of the vesting of the asset in a liquidator of a company or the holder of a similar office under a foreign law).

Despite this history we are not convinced that subsection (1) alone is sufficient to treat the individual as accountable for CGT in respect of all CGT events, particularly in the light of subsection (2) which treats only certain acts of a trustee as those of the bankrupt individual.

We therefore recommend that Treasury also consider whether an amendment is required to section 106-30 to ensure that the individual is accountable for CGT in respect of all CGT events and not simply acts done by the trustees referred to in subsection (2). If Treasury is of the view that this is not necessary, it would be helpful for the explanatory memorandum to the bill introducing the change to explain why this is the case.

- The proposed amendment to section 106-35 appears to be designed to mimic for liquidations the existing section 106-30 by expressly ignoring the vesting of company assets in a liquidator (where this is the effect of liquidation). This appears to be in addition to existing subsection 104-10(7) which ensures that the vesting of an asset in a liquidator does not trigger CGT Event A1.

However, for reasons set out in the above dot point, we are not convinced that this will of itself clear any doubt that the company is accountable for CGT in respect of all CGT events, including those which are not the result of an act of the liquidator, e.g. the loss or destruction of a company asset.

- In relation to Subdivision 106-C which deals with absolutely entitled beneficiaries, we understand that it is proposed that:
 - where a trust is created over a CGT asset by declaration or settlement or a CGT asset is transferred to a trust, a beneficiary who is absolutely entitled to that asset as against the trustee will be treated as the owner of the asset for CGT purposes and
 - where a beneficiary of an existing trust becomes absolutely entitled to an asset as against the trustee the beneficiary will similarly be treated as the owner of the asset for CGT purposes from that time and accountable for CGT in respect of CGT events occurring after that time.

Once again, we are not convinced that this of itself will result in the absolutely entitled beneficiary becoming accountable for CGT in respect of all CGT events that happen in relation to the asset and not simply those CGT events which result from the acts of the trustee.

The Proposals Paper is silent on whether, as part of these amendments, it will seek to address long standing issues in relation to the circumstances in which beneficiaries will be regarded as absolutely entitled to assets as against the trustee – see TR 2004/D25 which issued prior to the decision in *CPT Custodian*¹ and arguably does not reflect the decision in that case.

¹ (2005) 224 CLR 98

Areas of concern in relation to the existing rules, which will have a spill over effect on the proposed amendments, are the fact that:

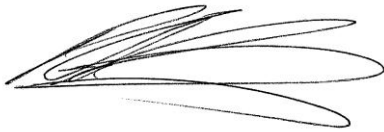
- as indicated in our earlier submissions, based on TR 2004/D25, where more than one beneficiary has an interest in an asset those beneficiaries will not be collectively absolutely entitled to the asset other than in limited circumstances and
- it is unclear whether the trustee's right of indemnity against a trust's asset would prevent a beneficiary from being absolutely entitled to that asset (which, contrary to TR 2004/D25, the decision in CPT Custodian suggests).

We recommend that Treasury consider legislatively clarifying these issues along the lines adopted in the UK where the relevant legislation expressly extends the absolutely entitled concept to jointly held property and excludes a trustee's right to be indemnified as affecting absolute entitlement. The text of Section 60 of the *Taxation of Chargeable Gains Act 1992* is attached.

- We understand that the proposed dates of application of the proposed amendments are intended not to disadvantage taxpayers other than where they have adopted a view of the law which was not intended and reserve our comments until such time as we see draft legislation.

Should you wish to discuss any aspect of our comments please call me on 02 9290 5609 or Susan Cantamessa on 02 9290 5625.

Yours sincerely



Paul Stacey
Tax Counsel
The Institute of Chartered Accountants in Australia

Extract from *Taxation of Chargeable Gains Act 1992***60 Nominees and bare trustees**

- (1) *In relation to assets held by a person as nominee for another person, or as trustee for another person absolutely entitled as against the trustee, or for any person who would be so entitled but for being an infant or other person under disability (or for 2 or more persons who are or would be jointly so entitled), this Act shall apply as if the property were vested in, and the acts of the nominee or trustee in relation to the assets were the acts of, the person or persons for whom he is the nominee or trustee (acquisitions from or disposals to him by that person or persons being disregarded accordingly).*
- (2) *It is hereby declared that references in this Act to any asset held by a person as trustee for another person absolutely entitled as against the trustee are references to a case where that other person has the exclusive right, subject only to satisfying any outstanding charge, lien or other right of the trustees to resort to the asset for payment of duty, taxes, costs or other outgoings, to direct how that asset shall be dealt with.*

