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2019 Private Business Tax Retreat

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PLENARY 8:

Structuring and planning: Before a realization event

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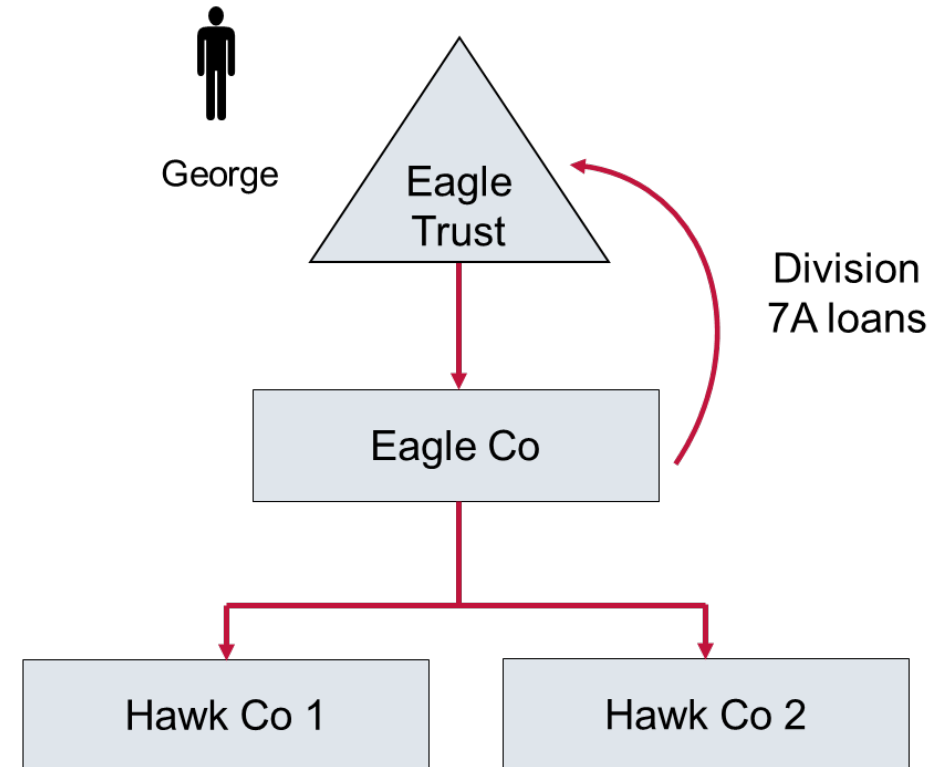
Overview

Case studies:

- Case study one – Division 7A loans and pre-sale dividends
- Case study two – correcting ownership structures and back to back rollovers
- Case study three – small business concessions and pre-sale planning

Case study one - Eagle Group

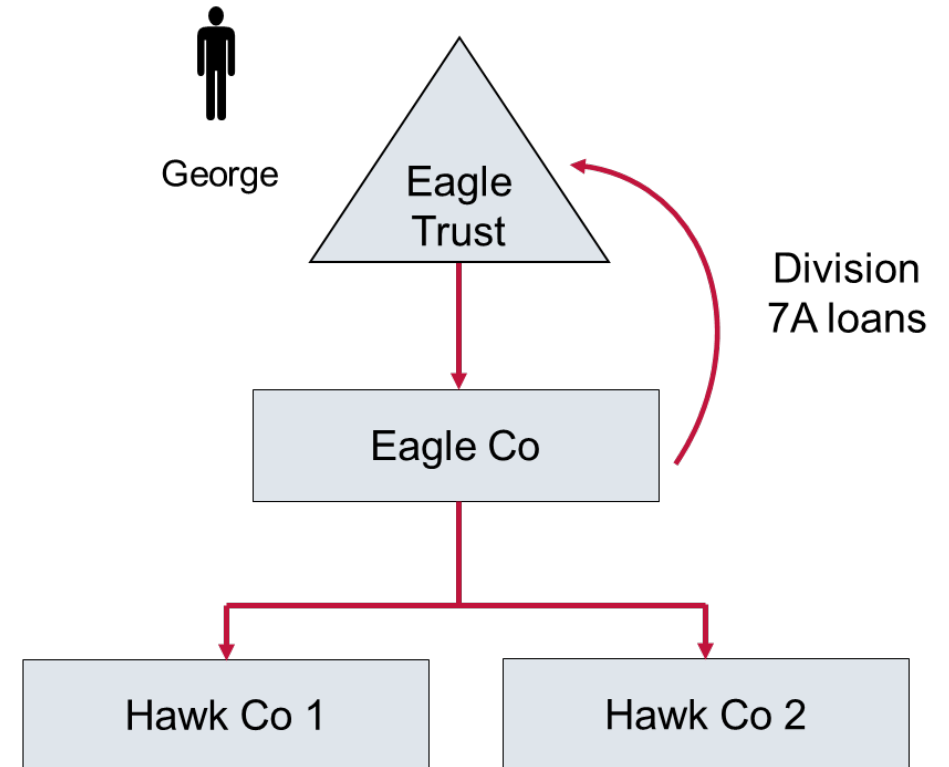
- George is the principal behind the Eagle Group
- Shares held by discretionary trust
- Division 7A compliant loans to trust





Case study one - Eagle Group

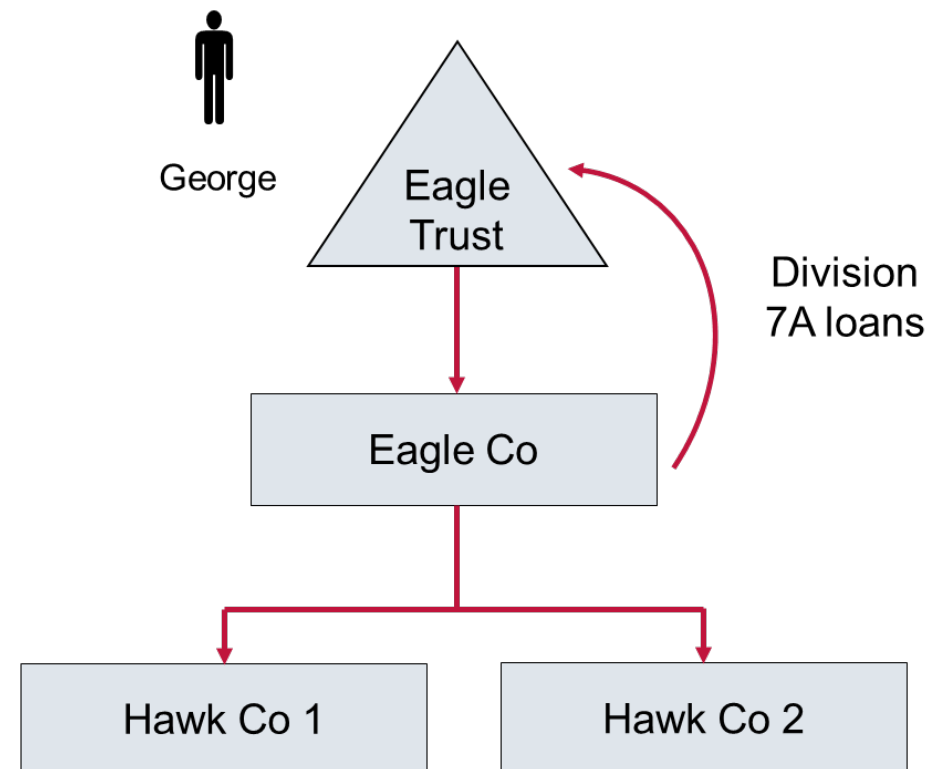
- Sale contract signed 1 September 19
- Contract unconditional 1 October 19 (assume materially diminished risk)
- Completion date 1 November 19
- Division 7A loans must be cleared by completion
- Purchase price to be subject to adjustments for cash and debt items





Case study one - Eagle Group

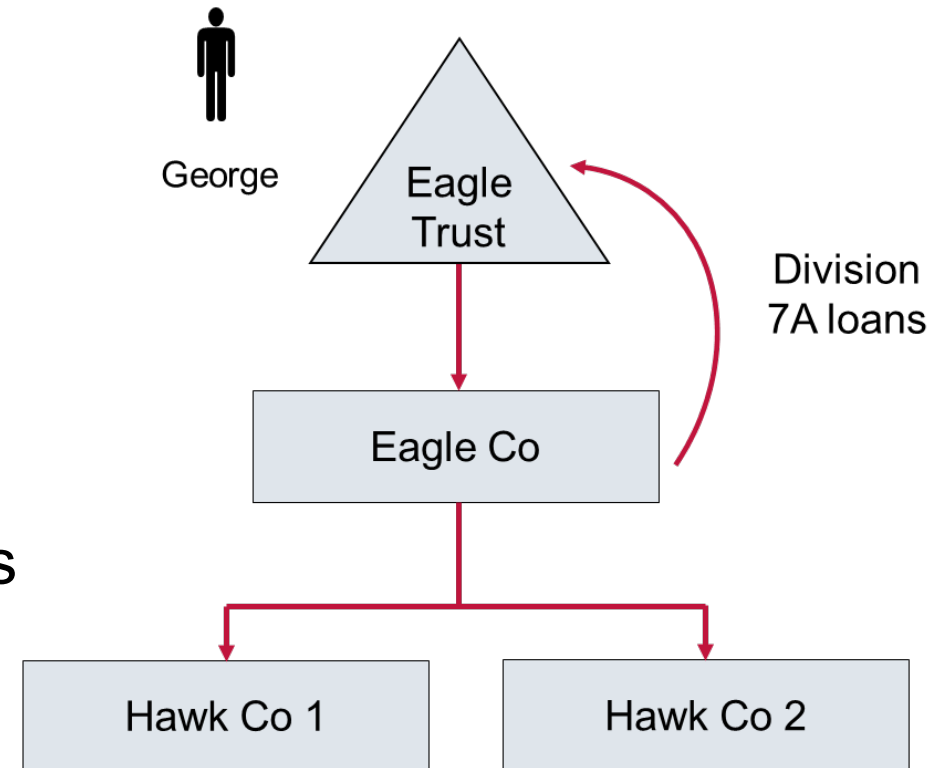
- Clearing division 7A loans:
 - Forgiveness – section 109F
 - Assignment – section 109F(5) – complex and needs careful monitoring, also consider duty
 - Repayment - preferable





Case study one - Eagle Group

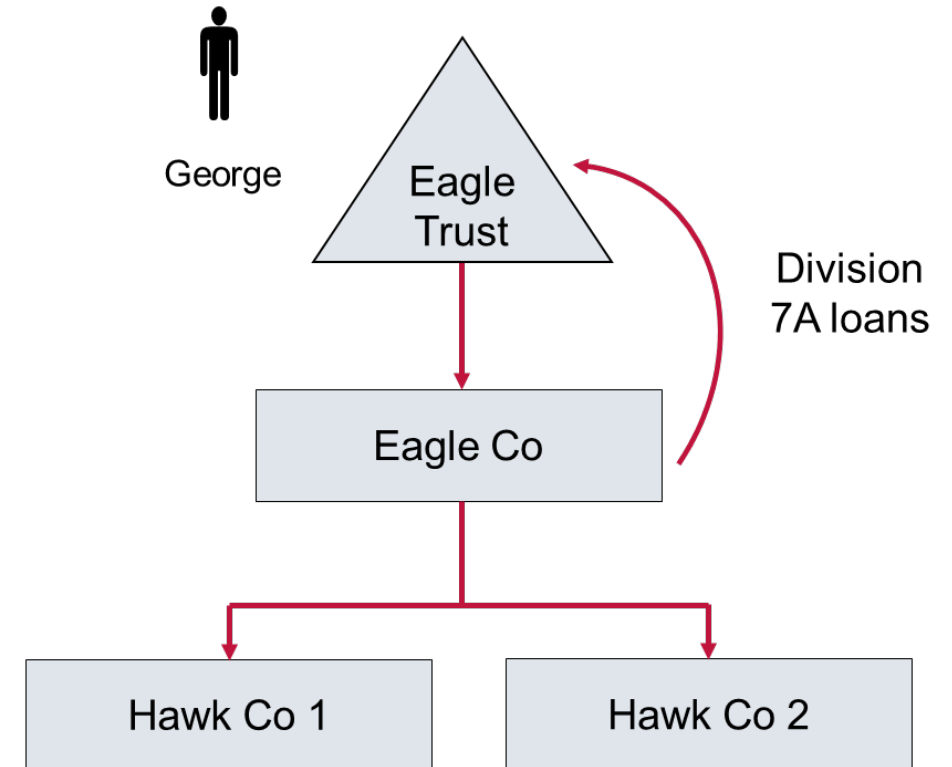
- Pre-sale dividend
 - Franking – requirement to be a ‘qualified person’ s207-145
 - Related payment – s160APHN ITAA 1936 (repealed)
 - Shares must be held at risk for 45/90 days within the relevant qualification period s160APHO ITAA 1936 (repealed)





Case study one - Eagle Group

- Sale proceeds
 - Capital proceeds increase (i.e. loans not offset pre-sale)
 - Purchaser funds repayment – may not be palatable

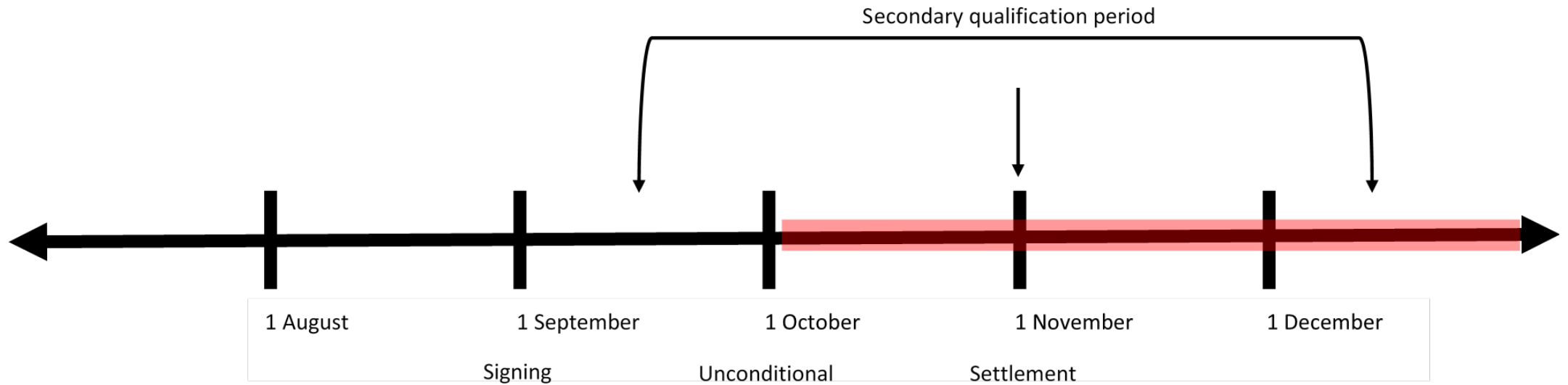




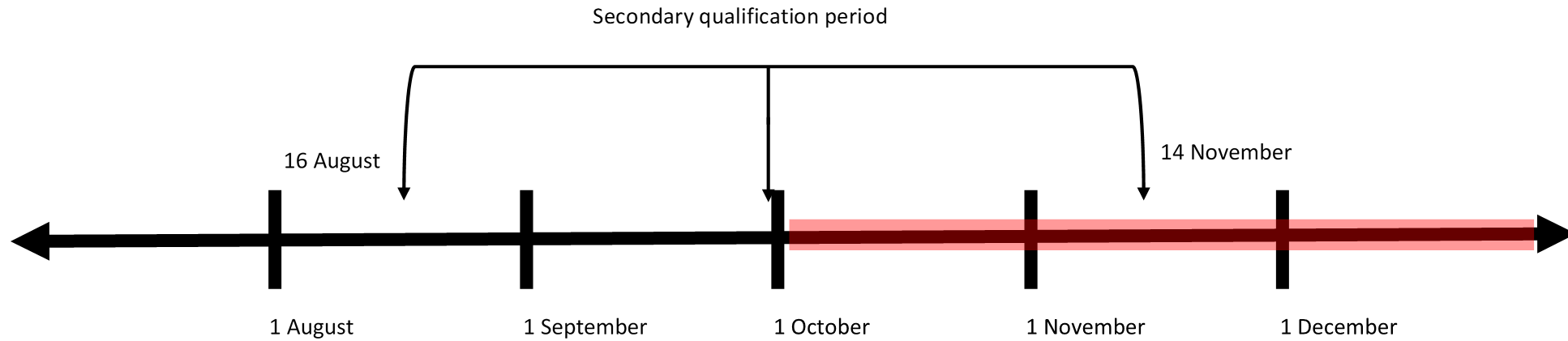
Case study one - Eagle Group

- ‘materially diminished risks’
 - If net position has 30% or less of the risk for opportunities or gain
- ‘primary qualification period’
 - Period beginning on the day after the day on which the taxpayer acquired the ordinary shares and ending on the 45th day after the day on which the shares became ex-dividend
 - 90 days for preference shares

Case study one - Eagle Group



Case study one - Eagle Group





Case study one - Eagle Group

- Tax preference will depend on profile of sellers. Various factors to consider in private business context, focused on the applicable tax rate :
 - SBC (case study 3 to follow)
 - Residency
 - Reduced corporate tax rate – franking applicable
 - Franking credits/ retained earnings available



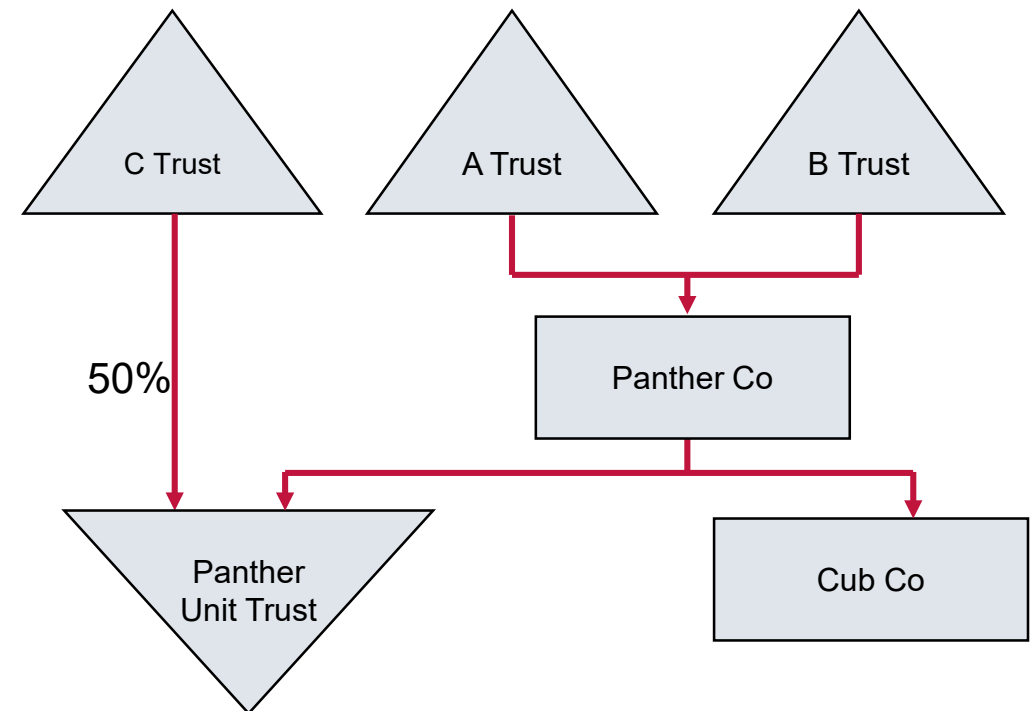
Case study one - Eagle Group

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Case study two – Panther Group

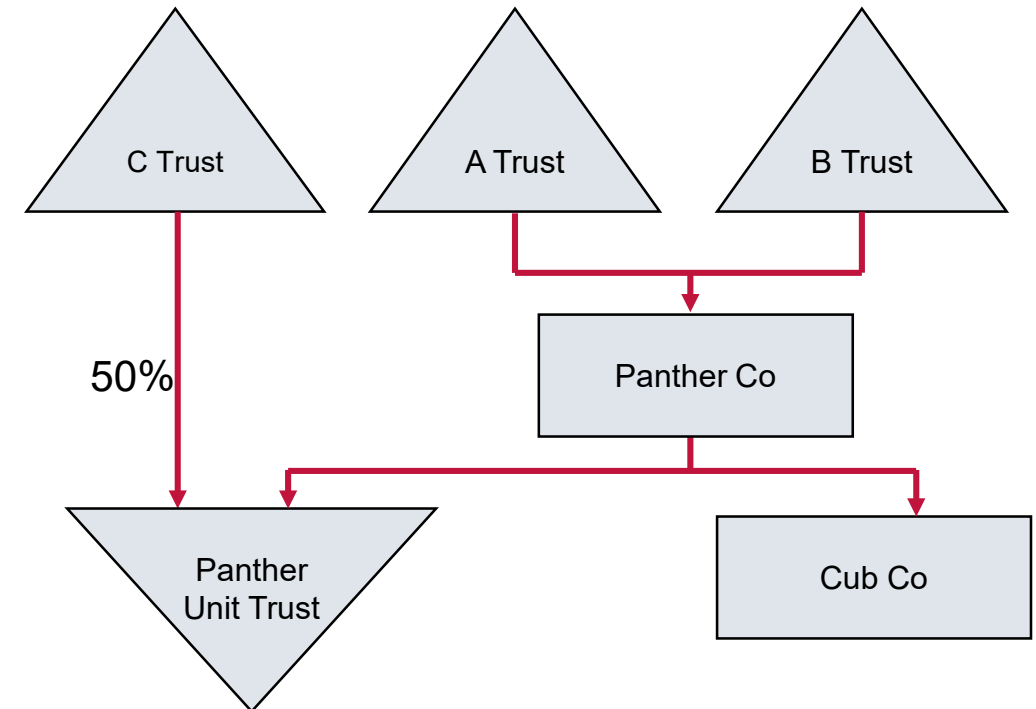
- A, B and C Trusts are discretionary trusts holding interests in Panther Co and Panther Unit Trust
- Shareholders trusts are unrelated entities
- Purchaser wants to take whole group





Case study two – Panther Group

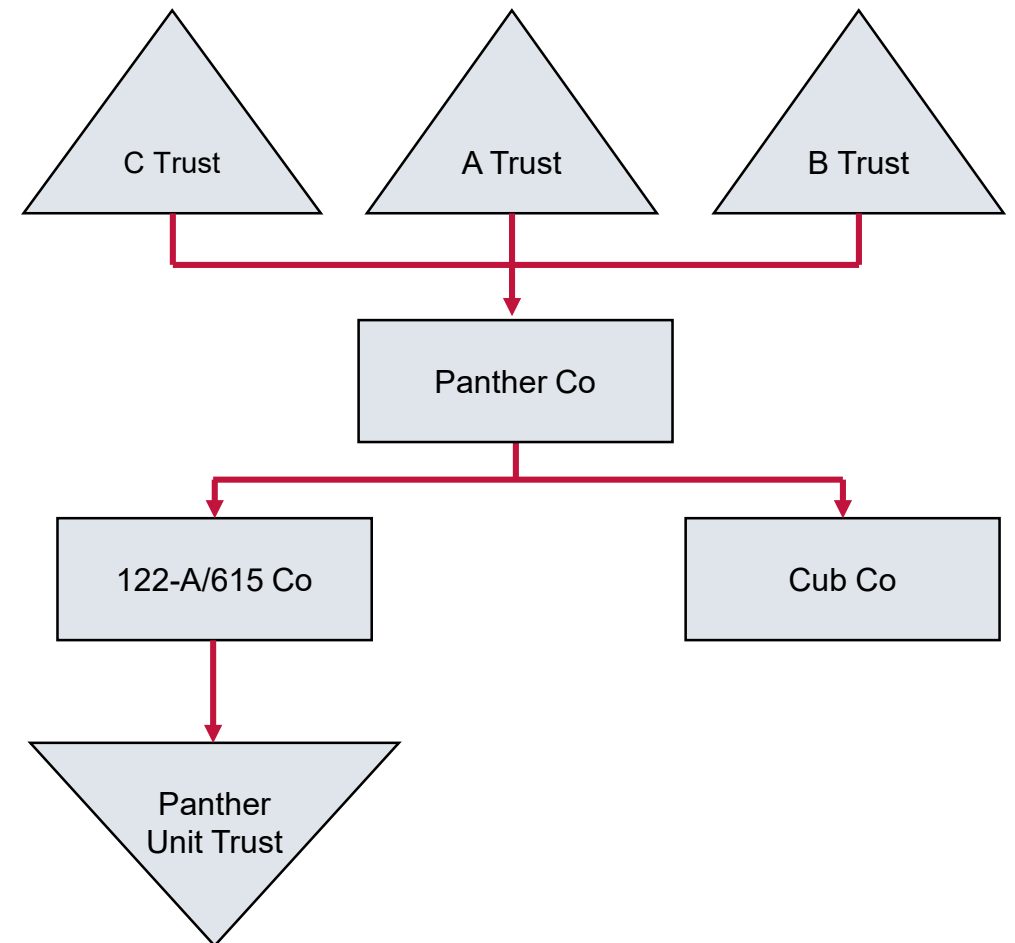
- Problems with structure:
 - Potentially separate negotiations with C Trust
 - C Trust unable to access scrip for scrip rollover with corporate group purchaser
 - Less attractive commercially





Case study two – Panther Group

- Rollovers to correct structure:
 - Division 615 or Subdivision 122A to interpose above Panther Unit Trust
 - Scrip for scrip rollover for Panther Co to acquire C Trust's interest in interposed company
 - Addresses commercial issues and allows access to scrip for scrip on eventual sale





Case study two – Panther Group

- Draft Taxation Determination on back-to-back CGT roll-overs
 - *'Income tax: capital gains: planned sequential transactions and the 'nothing else' condition of a roll-over'*
 - Expected completion October 2019
 - Purpose: *'The draft Determination will set out our preliminary view in relation to what is taken into account when applying the 'nothing else' condition of a CGT roll-over.'*
 - Possible application to both Division 615 and Subdivision 122-A



Case study two – Panther Group

- Back to back rollovers – effective?
 - CR 2018/31 – demerger relief denied in back to back circumstances
 - The ATO ruled at paragraph 38 that Demerger relief was denied on the basis:
‘it fails the nothing else requirement in paragraph 125-70(1)(c) of the ITAA 1997.’



Case study two – Panther Group

- CR 2018/31 – ‘nothing else’
 - The ATO ruled that demerger relief would not apply as:
 - "the requirement in s.125-70(1)(c) that under the restructuring, Westfield Shareholders acquire OneMarket Shares “and nothing else” in relation to their Westfield Shares will not be satisfied due to the nexus of the Demerger to the Unibail-Rodamco Transaction”*
 - “the transactions are economically contingent even if not legally inter-conditional”*



Case study two – Panther Group

- Division 615

615-5 - Disposing of interests in one entity for shares in a company

(1) You can choose to obtain a roll-over if...

*(c) under a scheme for **reorganising its affairs**, the exchanging members dispose of all their shares or units in it to a company (the interposed company) in exchange for shares in the interposed company **(and nothing else)**;*



Case study two – Panther Group

- Subdivision 122A

“122-20 - What you receive for the trigger event

*(1) The consideration you receive for the trigger event happening **must be only:***

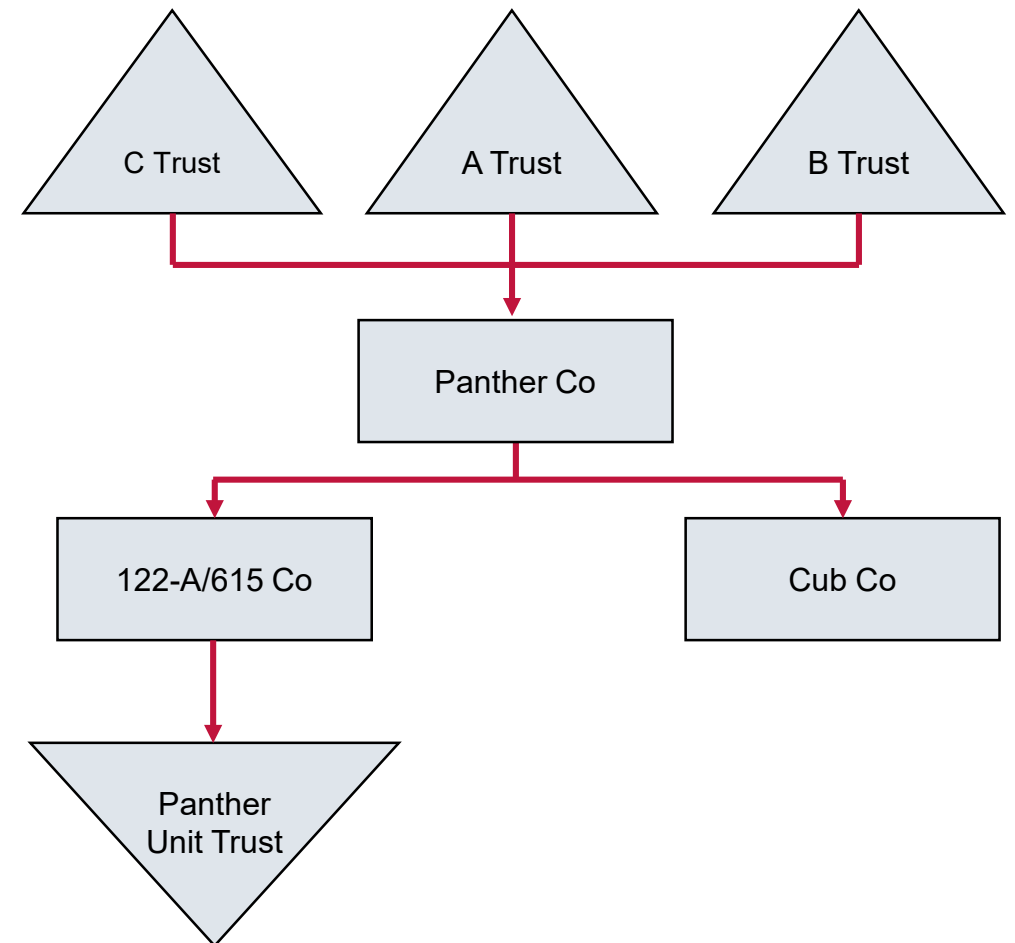
(a) shares in the company; or

*(b) for a *disposal of a CGT asset, or all the assets of a business, to the company (a disposal case)-shares in the company and the company undertaking to discharge one or more liabilities in respect of the asset or assets of the business (as appropriate).”*



Case study two – Panther Group

- Is subsequent scrip for scrip ‘economically contingent’?
- Does C Trust also receive some implied right to participate in subsequent scrip for scrip and any, following, any sale?





Case study two – Panther Group

- Back to back rollovers – effective?

- TD 2019/D1 – narrow view of what constitutes a ‘restructuring’ for demerger purposes:

‘[a restructuring] is not necessarily confined to the steps or transactions that deliver the ownership interests in an entity to the owners of the head entity of the demerger group, but may include previous or subsequent transactions in a sequence of transactions.’

- Taking a wide view of what constitutes the ‘restructuring’ then leads to the proportionality test in subsection 125-70(2) being failed.



Case study two – Panther Group

- Division 615 – ‘reorganisation’ requirement
 - Division 615 contemplates ‘a scheme for reorganising its affairs’.
 - Section 615-20 has a proportionality test
 - Concern as to whether the relevant ‘reorganisation’ includes subsequent steps such that the conditions are not satisfied.



Case study two – Panther Group

- See TR 97/18 concerning the meaning of ‘reorganisation’ under repealed provision s160ZZPA:
 - *29. A merger between two companies involves one entity absorbing another, or two or more companies uniting or combining. Accordingly, we consider that for the purposes of the application of section 160ZZPA **a merger cannot constitute a reorganisation**. Under a reorganisation no change occurs in the economic ownership of the underlying assets and the underlying assets in which the taxpayer has an economic interest do not change.*



Case study two – Panther Group

- Back to back rollovers – Part IVA?
 - CR 2018/14 concerned the availability of scrip for scrip rollover on a sale that appears not dissimilar to our case study per paragraphs 16 and 17.
 - The class ruling then states as follows at paragraph 36:
‘36. Scrip for scrip roll-over will not be available to the Original Unitholders where the Commissioner concludes that Part IVA of the ITAA 1936 applies to the internal restructure detailed at paragraph 17 of this Ruling.’



Case study two – Panther Group

- Part IVA – tax benefit
 - Making a choice to apply a rollover is, arguably, a discrete step with no other purpose than to obtain a ‘tax benefit’
 - Accordingly, where a tax benefit is ‘attributable to’ such a choice, it is carved out of the definition of ‘tax benefit’, under its various heads, in ss177C(2) of Part IVA.



Case study two – Panther Group

- Part IVA – tax benefit
 - However, this protection/ exclusion from the width of ‘tax benefit’ is limited by the following paragraph:
 - ‘[where] the scheme was not entered into or carried out by any person **for the purpose of creating any circumstance or state of affairs** the existence of which is necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised, as the case may be;’

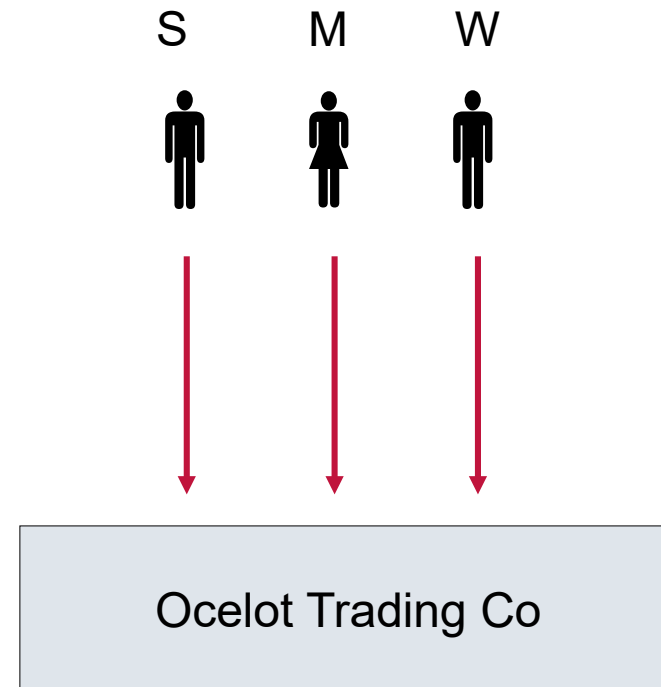


Case study two – Panther Group

- Part IVA – tax benefit
 - Does the carrying out of each respective Step 1, in our case study, constitute a scheme for the purpose of creating the relevant ‘state of affairs’ for the rollover under Step 2 to be claimed?
 - Does a narrow construction advance the policy intent behind the rollovers in the legislation?

Case study three – Ocelot Trading Co

- Stirling, Mallory and Woodhouse equal shareholders
- Shareholders individually satisfy MNAV test
- Ocelot Trading Co valued at \$6.25M by purchaser
- Significant retained earnings





Case study three – Ocelot Trading Co

- Changes to small business CGT concessions (SBCC) to introduce object entity rules
- Object entity must satisfy MNAV test or small business entity test
- Ocelot Trading Co:
 - Under old SBCC rules, shareholders entitled to concessions on disposal
 - Under new object entity rules, it fails MNAV test and SBCCs denied to shareholders
- Incentive to plan for disposal to allow access – is this possible?



Case study three – Ocelot Trading Co

- Planning to address object entity rules:
 - Keep value of the object entity down
 - Dividends are obvious solution
- Equally could be other reductions in value
 - Donations?
 - Bonuses?
- Similar issues arise for MNAV test for direct seller/shareholder
- Use object entity dividend scenario to consider issues



Case study three – Ocelot Trading Co

- Dividends – if the effect of a pre-sale dividend is to bring object entity to under \$6M market value, can the dividend be part of a Part IVA scheme?
 - if use the excess cash
 - if borrow funds to pay the dividend
- Does use of cash mean ‘excess’ assets – can be withdrawn?
- But funding by borrowings can be to adjust to a reasonable gearing – why not also are ‘excess’ assets?



Case study three – Ocelot Trading Co

- Is the underlying principle one of taking a ‘real’ action to satisfy a ‘tax condition’ for an available tax concession/benefit
- Here the ‘tax condition’ is the MNAV threshold and the action is the dividend
- Other actions – and tax benefit?
 - write off debt – bad debt deduction
 - forgive a debt – capital loss
 - sell interests to below 40% - not connected



Case study three – Ocelot Trading Co

- Does ‘real’ action matter - vs a step that does not effect a substantive (non-tax) change?
- Does size of tax benefit versus size of effect of ‘real’ action taken matter?
 - SBCC tax savings – exempts 50% of \$6M (15 year exemption) – tax saved up to \$1.41M (at 47%)
 - Versus dividend of \$800K
- Failure to respect ‘real’ actions - generates inconsistent outcomes



Case study three – Ocelot Trading Co

- When is seeking to meet a ‘tax condition’ by a ‘real’ transaction not acceptable – and why?
- ‘Tax conditions’ are not meant to be (should not be) ‘traps’
- Anti-avoidance interpretations that prevent straight forward satisfaction of such ‘tax conditions’ seem to imply extra conditions into the law around those ‘tax conditions’
 - on what basis?
 - such extra conditions may defeat the original intention of the law?



Case study three – Ocelot Trading Co

- But – practically - should business owners be keeping retained earnings down to just avoid Part IVA risk?
 - Does this incentivise moving value out of operating companies into bucket companies?
 - What are the limits when action becomes avoidance - what time frame(s) is(are) enough to create enough of a 'gap' between dividend(s) and sale?
And why is that time frame enough?
- Can agree? - should not depend on subjective intention (the well-advised always caught because they think about these things?)



Case study three – closing comments - other possible areas

- Also – if even object entity MNAV test met – may be MNAV issues at shareholder level as well
 - Similar MNAV planning
 - Use turnover test?
 - Start/buy a small business? – must now be ‘just before’ CGT event (i.e. before contract signed)
- Also – if were subsidiaries below Ocelot Trading Co
 - plan to meet the ‘later entities’ requirements for shares to be active assets



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