

JOINT SUBMISSION BY

Institute of Public Accountants, The Tax Institute, CPA Australia, Chartered Accountants Australia and New Zealand and Taxpayers Australia

Law Companion Guideline LCG 2016/D2 & LCG 2016/D3 - Law Companion Guidelines: Small Business Restructure Rollover: consequences of a roll-over and genuine restructure of an ongoing business

Date due: 6 May 2016

Thank you for the opportunity to comment on Law Companion Guideline 2016/D2 and 2016/D3 which deal with small business restructure roll-over.

LCG 2016/D2 explains the consequences and adjustments that occur when the transferor and transferee choose to apply the Small Business Restructure Roll-over (SBRR) in Subdivision 328-G of the *Income Tax Assessment Act 1997* (ITAA 1997).

LCG 2016/D3 explains the meaning of '*genuine restructure of an ongoing business*' as the term is used in Subdivision 328-G of the *Income Tax Assessment Act 1997* (ITAA 1997)

GENERAL COMMENTS

These law companion guidelines provide early guidance on how the ATO will apply the recently enacted small business restructure roll-over laws. The new SBRR rules introduce some new concepts so we welcome some early guidance material ahead of their 1st July 2016 commencement date. Given that SBRR applies to small business entities which are in the main serviced by one or two person practices, it is important that the new laws can be interpreted without too much uncertainty.

SPECIFIC COMMENTS

In relation to the law companion guidelines we make the following points.

LCG 2016/D2 and D3

1. SBRR applies only where the eligibility requirements are satisfied which are partly covered in LCG 2016/D3. We suggest that that LCG 2016/D3 be numbered D2 and vice versa even though paragraph 2 recommends reading draft LCG guidelines on the SBRR together.

LCG 2016/D3 – genuine restructure of an ongoing business

2. Based on the way it is currently drafted, paragraph 15 implies that even if a restructure satisfies the safe harbour criteria set out in section 328-435 to be regarded as a genuine restructure for the purpose of section 328-430(1)(a), the Commissioner may still apply Part IVA to the restructure when considering the 'purpose and effect of the restructure for other tax purposes'. It is unclear how this interpretation has been arrived at.

In the ordinary course, where a taxpayer satisfies safe harbour criteria, they should not be at risk of Part IVA applying. The only interaction between Part IVA and the SBRR provisions is considered in the context of section 328-450 in relation to the requirement that small business restructure rollovers should not affect tax positions

(i.e. they should be tax neutral). Paragraph 1.50 of the Explanatory Memorandum to the *Tax Laws Amendment (Small Business Restructure Roll-Over) Act 2016* provides that section 328-450 does not prevent Part IVA from applying to a scheme involving the application of the roll-over.

Could the ATO please provide clarification on how the interpretation in paragraph 15 has been arrived at? We also request that the ATO include a couple of examples outlining the circumstances in which Part IVA could apply to a restructure which qualifies for SBRR, with and without the aid of the safe harbour rule.

We also think that, subject to the outcome of the above, Example 7 should be deleted from the LCG as it is confusing.

3. In relation to Example 6 dealing with succession planning we make a couple of observations:
 - Paragraph 59 should read that SBRR is not available to Holding Co and Gone Fishing Inc, being the parties which elected for SBRR.
 - The transfer of the 'Fish' business was done for market value, i.e. the issue of shares, so there was no wealth transfer as that term is ordinarily understood. There may be a transfer of wealth if the shares in the companies were sold for less than market value but the example is silent on this. We suggest that the example use neutral language, e.g. succession planning as in the title of the example.
4. In our view LCG 2016/D3 would benefit from a number of additional examples:
 - a. As noted in (2) above, in our view the LCG should include a couple of examples dealing with the interaction of the SBRR rules and Part IVA. One might be an example where an individual is running a small business as a sole trader and wants to transfer the business into a discretionary trust that includes himself as the specified individual in circumstances where limited liability is not a driver. It would be good to have an example of this scenario to identify the issues where there is little apparent business benefit to satisfy a genuine business restructure (unless the safe harbour rule can be satisfied) and the possible application of Part IVA. Tax practitioners servicing small business taxpayers may gloss over the finer details of what is required in order to satisfy the genuine business restructure criteria.

Paragraph 17 of LCG 2016/D3 does cover the scenario of an individual moving into a discretionary trust structure for asset protection purposes which also generates tax benefits. The assumption is that the need for asset protection outweighs the tax benefits making the transfer not unduly tax driven.
 - b. Another example is where an asset is transferred to a discretionary trust from an individual or a company owned by an individual and the discretionary trust makes a family trust election nominating the individual's brother for example as the specified individual. The transfer would appear to pass the ultimate economic ownership test for family trusts because the individual is a family member of his brother. In these circumstances it would be open to the trustee of the family trust to start distributing income and capital gains to the individual's brother and the brother's family, in effect transferring the business from the individual to the brother and his brother's family without any tax consequences. What would the ATO be looking for in determining whether it was a genuine restructure under this scenario? Would Part IVA apply if the safe harbour conditions are satisfied?

The mere fact that an individual is part of the family group may not mean that the individual has, or is one of the persons who have, the ultimate economic ownership of a particular asset that is an asset of the trust so an example of the above scenario will clarify this point with greater certainty.

- c. What happens where there are spouses in business together, there has been a genuine restructure under section 328-430(1)(a) and a marriage breakdown occurs? Are the taxpayers precluded from applying the safe harbour rule in section 328-435 if a marriage breakdown occurs requiring a restructure within three years?
 - d. None of the existing examples deal with the situation where a business restructure results in a structure likely to have been adopted had the small business obtained appropriate professional advice when setting up the business. As this is one of the features cited in para 7 as indicative of a transaction which is, or is part of, a genuine restructure of an ongoing business, we recommend the inclusion of an example which relies in whole or part on this feature. The fact pattern described in (4)(a) above might well be one where, properly advised, the sole trader would have opted for a discretionary trust from the start.
5. We request the ATO include a comment about what happens when a restructure involves a company that has a number of classes of shares. This should draw out the issue of ultimate economic ownership in relation to shares in a company (in much the same way as the additional example suggested in 4(b) above should elaborate on this issue in relation to discretionary trusts).

LCG 2016/D2 – consequences of a roll-over

6. In 'What this draft Guideline is about' we recommend that you include a statement to the effect that the examples in the guideline:
- assume that the restructure is permitted by the relevant entity's constituent document(s);
 - consider only the income tax consequences of the restructure and not any other federal or state taxing statutes, the Corporations Act or the various state legislation regulating trusts; and
 - do not consider the accounting implications of the transactions.

We make this suggestion not only for the benefit of the ATO but also as an alert to readers that the SBRR rules may have other consequences.