



TREASURER



NO. 9

EMBARCO

STATEMENT BY THE TREASURER, THE HON P.J. KEATING, M.P.  
CAPITAL GAINS TAX (CGT) : FURTHER ROLLOVER RELIEF

On 29 September 1987 in announcing a decision to extend capital gains tax rollover relief - that is, deferral of CGT liability - to a particular form of reorganisation of unit trusts, I indicated that a more wide ranging review of the rollover relief provisions was nearing completion.

That review is now complete and the Government has decided to extend rollover relief to a number of additional kinds of business reorganisations. A number of technical amendments will also be made to the existing rollover measures.

Interposition of a company into an existing business structure

Rollover relief is to be given where in a reorganisation a resident company is interposed between shareholders and an existing resident company where the shareholders exchange their holdings of shares in the original company for shares in the interposed company.

Consistent with the measures to give rollover relief for reorganisations of unit trusts announced on 29 September 1987 being given effect by the Taxation Laws Amendment Bill (No.5) 1987, the following conditions will apply :

the consideration for the disposal of shares in the original company consists solely of non-redeemable shares in the interposed company;

the interposed company is, immediately after the reorganisation, the sole shareholder in the original company; and

the former shareholders become the sole shareholders in the interposed company, holding shares carrying for each the same proportionate interests in the worth of the company as the shares they held in the original company immediately before the reorganisation.

It will also be a requirement that the interposed company elects for rollover relief to apply and certifies that the conditions have been satisfied.

Where the interposed company elects to have rollover relief apply, the shareholders will be able to choose between having their shares in the original company treated as being disposed of at that point or rolling them over so that any CGT liability is not determined until there is a subsequent disposal of the new shares in the interposed company.

A shareholder who elects for rollover relief will be taken to have acquired the new shares before 20 September 1985 - so as not to be subject to CGT - if the original shares were acquired before that date. New shares taken to have been acquired on or after 20 September 1985 will assume the cost base, reduced cost base or indexed cost base of the shares in the original company as at the date of the exchange, for the purposes of determining any future tax liability on a subsequent disposal of the new shares.

Where the interposed company elects for rollover to apply, the election must be made in respect of all the shares in the original company and the cost base of those shares in the hands of the interposed company will be determined by reference to the underlying assets of the original company as follows :

where some assets of the original company were acquired prior to 20 September 1985, a proportion of the shares in the original company will be deemed to have been acquired by the interposed company prior to that date; the proportion being calculated as the ratio of the net market value of the pre-20 September 1985 assets at the time of the reorganisation to the net market value of all the assets of the original company at that time; and

the cost base, reduced cost base or indexed cost base of the balance of the shares (that is, other than those deemed to have been acquired before 20 September 1985) will be determined by aggregating the cost bases, reduced cost bases or indexed cost bases of the post-19 September 1985 assets (less liabilities) of the original company at the date of the exchange and allocating these amounts equally across all the shares. Indexation will not apply to any such shares disposed of within 12 months of the reorganisation.

These arrangements are to have effect with respect to reorganisations entered into after today.

#### Crown leases

Under the existing CGT legislation the surrender or expiry of a lease of land is treated as the disposal of an asset and the renewal of a lease is treated as the acquisition of a new asset. If a lease was acquired before 20 September 1985, no CGT consequences arise on renewal of that lease on or after that date but the new lease is subject to CGT at the time of any subsequent disposal. The market value of the original lease is generally required to be included in the cost base of the new lease for tax purposes. However, if the original lease was acquired on or after 20 September 1985, the market value of the

new lease is taken to be the consideration received on disposal of the lease it replaces and a CGT liability could arise as a result.

It has been put to the Government that for all intents and purposes there is little difference between a Crown lease and a freehold interest in land because a Crown lessee is usually entitled to compensation for improvements made to the leasehold land and can ordinarily expect that the lease will be renewed.

The Government has decided to allow rollover relief on the renewal, extension or conversion to a lease in perpetuity of a Crown lease of land where the new or extended lease is over the same or substantially the same land. This will have the effect of preserving CGT-exempt status where the original Crown lease was acquired before 20 September 1985 and, in other cases, of ensuring that no CGT liability arises until the lease is disposed of to a third party or is otherwise terminated.

This change will be back-dated to apply from the commencement of the capital gains tax provisions so that tax will not apply to renewals, extensions or conversions of Crown leases of land made in the period since 19 September 1985. The change will not apply to other leases.

Concerns have also been raised about the operation of the existing law where a leasehold interest in land is converted to a freehold interest. The present law deems the acquisition of the freehold interest to have occurred on the date when the original leasehold interest was acquired if the lease was granted for a minimum term of 99 years. The Government has now decided that this concession should be available in respect of all conversions of Crown leases of land to freehold.

The amendment will apply for conversions on or after 20 September 1985.

#### Statutory licences and authorities

This group of assets includes such things as taxi licences, radio and television broadcasting licences, and prospecting and mining rights. They share the characteristic of being created by the application of statutory powers and the rights attaching to the grant are generally subject to periodic renewal or extension. Where the holder of the asset has complied with the terms and conditions of the grant there is generally an expectation of, but not a legal right to, renewal or extension.

Under the existing CGT rules the expiry or surrender of such an asset amounts to a disposal of the asset. Where a licence or authority acquired before 20 September 1985 is renewed or extended after that date, the renewed asset is subject to capital gains tax on disposal. Representations to the Government have maintained that, where there is no change in the beneficial ownership of such an asset on the renewal or extension, it should not be treated as a disposal at that time.

The Government has decided to permit rollover relief where a licence or authority (including a mining or prospecting right) issued by a government or government authority is renewed or extended, subject to the requirement that there is no change in beneficial ownership. This will preserve the capital gains tax exempt status where such assets were first acquired before 20 September 1985 as well as ensuring that there is no disposal for CGT purposes by virtue of the renewal or extension.

This measure will also be back-dated to have effect for renewals or extensions on or after 20 September 1985.

#### Conversion of prospecting right to mining right

The Government also examined the scope of existing capital gains rules under which a transition from the prospecting or exploration stage to the mining stage is not treated as the disposal of the prospecting right, and does not cause the loss of a pre-CGT status, as the new mining right or lease is taken to have been acquired on the date of acquisition of the prospecting right.

Under mining legislation controlling exploration and mining operations, non-prospective areas the subject of the prospecting or exploration rights are often relinquished at the time of expiry of those rights and not included within the new mining right or lease issued to the holder of the rights. In other situations a number of separate prospecting rights over adjacent areas may be consolidated in a single new mining right or lease.

The Government has decided to amend the relevant capital gains tax rollover measures to cover the additional situations just outlined, provided at the time of issue of the new mining right or lease there is no change in beneficial ownership.

The amendments will apply to a mining right or lease acquired on or after 20 September 1985.

#### Involuntary disposals

Under the existing rollover relief for involuntary disposals of assets a taxpayer who is subject to the compulsory acquisition of an asset, and who purchases a replacement asset within a stipulated period or receives an asset by way of compensation, is entitled to defer CGT liability until there is a disposal of the replacement asset. It has been represented that rollover relief should also extend to a situation where a government or government authority has given notice of its intention to acquire an asset, but the asset is disposed of to the authority under voluntary agreement, rather than by the compulsory acquisition processes.

In response, the Government has decided to extend rollovers to cover such situations where the asset is disposed of to the government or government authority (but not to a third party). The amendments will apply to the disposal of an asset on or after 20 September 1985.

Another technical source of difficulty in this area lies in the rule that a replacement asset assumes a pre-20 September 1985 acquisition date if the original asset was acquired prior to that date. It is a requirement that the value of the replacement asset not exceed 120 per cent of the market value of the original asset immediately prior to its disposal. In the case of the loss or destruction of an asset, where an amount is received in respect of the loss or destruction, the time of disposal of the asset dates from when the first payment of this amount is received.

In cases of loss or destruction the difficulty for a taxpayer who wishes to take advantage of rollover relief, may be that the market value of the asset immediately prior to its deemed disposal will only be that of a damaged or destroyed asset.

The Government has decided to correct this so that the relevant value of the original asset will be its value immediately prior to the loss or destruction. The amendment will apply for a disposal on or after 20 September 1985.

#### Transfer of an asset to a wholly owned company

Rollover relief is only available on the incorporation of the business of a partnership where one of the partners is a natural person. This restriction is to be removed.

In addition, the law will be amended to permit rollover relief where the partners are trustees, if immediately after incorporation the trustee/partners own shares in the company in the same proportions as their partnership interests and hold them on the same trust and for the same beneficiaries as they were held prior to incorporation.

The changes will apply in respect of transfers of assets after today.

#### Public trading unit trusts

In 1985, changes were made to the taxation of public trading trusts. These changes have effect from 1 July 1988 for trusts established prior to 20 September 1985. As a result of these changes, public trading trusts may wish to reorganise.

The Government has decided to amend the existing CGT provisions to provide rollover relief for a type of reorganisation under which such a unit trust makes a proportionate distribution in specie to its unitholders of shares held by the trust in a company where the shares were acquired before 20 September 1985. This change will apply in respect of a transfer of shares after today and before 1 July 1988.

Rollover relief will apply where the unitholder elects for rollover relief and where only shares are received. Where the units were acquired by the unitholder before 20 September 1985, the shares will also be taken to have been acquired before that date.

In the case of units acquired after 19 September 1985 no election will be required and the shares will be taken to have been acquired by the unitholder after that date. The cost bases of such shares will be determined by their market value, while the cost bases of the units will be adjusted by the market value of the shares received in the same way as the law now applies to a return of capital.

#### Transfer of assets upon breakdown of marriage

An automatic rollover applies to asset transfers between spouses incident to the breakdown of legal marriages where they are effected pursuant to an order of, or a maintenance agreement sanctioned by, a court under the Family Law Act.

However, in some cases, the court order or approved agreement may include the transfer of assets from a company or trust to the spouse.

The Government has decided to extend the automatic rollover relief currently applying to transfers of assets between spouses, to court directed or sanctioned transfers of assets between a company or trust and the spouse.

This means that if the transferred asset was acquired by the company or trust before 20 September 1985, the spouse receiving the asset will also be taken to have acquired the asset before that date. For assets acquired on or after 20 September 1985, the cost base, reduced cost base and indexed cost base of the asset will be transferred. Proportionate adjustments will also be made to the cost bases of the interests subject to CGT held directly or indirectly in the company or trust to reflect the reduction in value of the interests as a result of the transfer. In the case of assets acquired after 19 September 1985, the adjustment will be based on the cost bases of the assets transferred, while, market value will be used for assets acquired before 20 September 1985.

The amendment will apply to transfers of assets after today.

#### Taxable Australian assets

Rollover relief is also available where a taxpayer, whether a resident or a non-resident, transfers a taxable Australian asset to a company that is a non-resident.

A technical argument has been raised that in some situations such an asset is not a "taxable Australian asset" in the hands of the non-resident company. In addition, shares received in exchange for the transfer of a taxable Australian asset are not themselves taxable Australian assets in the hands of a non-resident.

It is proposed to amend the law to ensure that where a taxable Australian asset is transferred and rollover relief is available, the asset is taken to be a taxable Australian asset in the hands of the transferee and an asset received in consideration for the disposal is also a taxable Australian

asset. This amendment will apply in respect of an asset disposed of after today.

#### Unit trusts

Rollover relief allowed for certain company transactions does not extend to comparable transactions of unit trusts. The transactions are ;

rights or options to acquire new shares or further options, issued by a company for no consideration to existing shareholders ;

convertible notes issues; and

share splits or consolidations.

The provisions relating to the first two situations state specifically that the exercise of the right or option or of the option contained in the convertible note is not a disposal giving rise to a CGT liability at that time, but rather any liability arises when the shares obtained by the exercise are sold. Special rules apply where the right or option was, or was deemed to have been, acquired before 20 September 1985 and the exercise of the right or option occurs on or after that date. Generally, in these circumstances, the shares obtained are taken to have been acquired for the sum of the market value of the right or option at the time of exercise and the exercise price.

In addition, rollover relief is available for the reorganisation of the share capital of a company involving transactions which may broadly be described as share splits or share consolidations.

The Government has decided that rights or options to acquire new units, convertible notes issued by unit trusts and unit splits and consolidations should be treated in the same manner as their counterparts are for companies.

The amendments will apply in respect of rights, options or convertible notes issued after today and for unit splits or consolidations carried out after today.

#### Exchange of rights or options in the same company

Finally, the present rollover relief for transactions involving share splits or share consolidations is to be extended to cover splits or consolidations of company issued rights or options to acquire shares and of rights or options to acquire units issued by unit trusts. These changes will be effective for disposals of assets after today.

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