

CRP 2017/2 - Explanatory statement -

Explanatory Statement

Taxation Administration (Remedial Power – Small Business Restructure Roll-over) Determination 2017

General outline of determination

1. This determination is made under section 370-5 of Schedule 1 to the *Taxation Administration Act 1953* (TAA). All references to legislative provisions in this Explanatory Statement are references to the *Income Tax Assessment Act 1997*, unless otherwise stated.
2. This determination modifies the operation of:
 - section 40-340; and
 - any other provisions of a taxation law the operation of which is affected by the operation of that section (as modified by this determination) in relation to an asset covered by item 8 of the table in subsection 40-340(1)

to ensure that no direct income tax consequences will arise from the transfer of depreciating assets undertaken as part of a transaction that otherwise qualifies for small business restructure roll-over relief under Subdivision 328-G.
3. This determination is a legislative instrument for the purposes of the *Legislation Act 2003*.

Date of effect

4. This determination commences on the first day the determination is no longer liable to be disallowed, or to be taken to have been disallowed, under section 42 of the *Legislation Act 2003*.

What is the effect of this determination?

5. The modification made by this determination applies where an entity transfers a depreciating asset or assets in the course of carrying out a genuine restructure of a small business as provided by Subdivision 328-G.
6. The effect of this instrument is to ensure that, where the restructure otherwise satisfies the conditions for roll-over under Subdivision 328-G, the transfer of depreciating assets will have no 'direct income tax consequences'. This will align the treatment of depreciating assets with the treatment of CGT assets, trading stock and revenue assets.
7. This modification will most commonly apply where the restructure involves the transfers of depreciating assets by the trustees of trusts to beneficiaries, by companies to shareholders, and other associated persons. In the absence of the modification, such transfers could give rise to assessable income in the hands of the transferee.

8. The modification made by this determination does not apply to an entity if the modification would produce a less favourable result for the entity (subsection 370-5(4) of Schedule 1 to the TAA).

Background

9. The small business restructure roll-over (SBRR) was enacted with effect from 1 July 2016 to give small businesses flexibility by enabling them to change their legal structure without immediate income taxation consequences. It applies to transfers of CGT assets, trading stock, revenue assets and depreciating assets that occur in the course of a 'genuine restructure of an ongoing business'.
10. The SBRR is intended to be broadly tax-neutral, in the sense that no direct income tax consequences are intended to arise from the transfer of qualifying assets.
11. Generally, the roll-over applies to transfers that do not result in a material change in the ultimate economic ownership of the assets.

Explanation

12. Under the SBRR, the statutory mechanism for delivering the roll-over differs depending on the type of assets being transferred. CGT assets, trading stock and revenue assets are subject to a general rule in section 328-450 that, except as provided in Subdivision 328-G, 'the transfer of an asset has no direct consequences under the income tax law'. However, the relief for the tax consequences for the transfer of depreciating assets, as provided under section 40-340, is more limited.
13. As enacted, the roll-over in section 40-340 is in relation to the 'balancing adjustment' consequences that would otherwise arise from the transfer of depreciating assets. That is, it enables the parties to the transfer to postpone the assessable income or tax deduction that would otherwise arise from the transferring of the asset for an amount above or below its 'adjustable value' for tax purposes. It also provides a mechanism for the transferee to continue to depreciate the asset.
14. The transfer of depreciating assets in the context of a business restructure can have other direct income tax consequences, in addition to the balancing adjustment consequences addressed in Division 40. For example, where the transferring entity is a company, the transfer may give rise to a dividend (or deemed dividend) in the hands of the recipient.
15. The Commissioner considers that the intended purpose or object of the SBRR extends to providing relief from all 'direct tax consequences' of the transfer of depreciating assets. Through this determination, the operation of item 8 of the table in subsection 40-340(1) is extended. The extension will ensure that no direct income taxation consequences will arise from the transfer of depreciating assets other than those arising under Division 40. The modification does not change the depreciation tax cost setting process in Division 40.
16. This modification is consistent with the intended purpose or object of Subdivision 328-G and is reasonable to provide certainty and flexibility to the owners of small businesses who wish to change the legal structure of the business without adverse tax consequences.
17. The example below illustrates how the current law applies in the absence of the determination.

Example: Assessable income includes the value of the depreciable plant following the transfer

18. Fiona owns all of the shares in Orange Country Pty Ltd which is a small business entity. Fiona decides to restructure her business to operate as a sole trader. She causes the company to transfer all of its assets including an item of depreciable plant for no consideration.
19. Under the capital allowance provisions, Orange Country Pty Ltd is taken to receive market value consideration for the transfer of plant. The company is entitled to choose roll-over and defer the tax consequences from the balancing adjustment event.
20. If the depreciable plant is paid out of profits derived by Orange Country Pty Ltd, Fiona's assessable income will include the market value of the plant, pursuant to section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936). Alternatively, the amount would be an assessable deemed dividend pursuant to section 109C of ITAA 1936.

Modification is not inconsistent with intended purpose or object of the provision

21. The Commissioner considers the modification is not inconsistent with the intended purpose or object of the provision, being item 8 of the table in subsection 40-340(1). In ascertaining the intended purpose or object of the provision, consideration was given to the explanatory memorandum relating to the bill containing the provision.
22. The explanatory memorandum states that the Income Tax Assessment Act 1997 was amended to enable small businesses to defer the recognition of gains or losses that may arise from the transfer of capital gains tax assets, trading stock, revenue assets, and depreciating assets as part of a genuine restructure of their business.¹
23. This will be achieved 'with a new roll-over for gains and losses arising from the transfer of CGT assets, trading stock, revenue assets and depreciating assets as part of a restructure of a small business', thereby providing 'small businesses with the flexibility to change their legal structure without realising an income tax liability on the transfer of those assets'.²
24. The explanatory memorandum is explicit in stating that the relief is intended to apply to transfers of trading stock, revenue assets, and depreciating assets.³
25. The Commissioner considers that it will be inconsistent with the intended purpose or object of the provision to treat depreciating assets as a special category. That is, it will be inconsistent with the intended purpose or object to provide more limited relief to depreciating assets than other asset types. The modification will remove an impediment to achieving tax neutrality for small business owners who undertake qualifying restructures.

¹ Explanatory Memorandum, Tax Laws Amendment (Small Business Restructure Roll-over) Bill 2016, pages 1, 7.

² Ibid, page 6.

³ Ibid, para 1.10.

Modification is reasonable

26. The Commissioner considers the modification to be reasonable, having regard to the intended purpose or object of subdivision 328-G and to whether the cost of complying with the provision is disproportionate to achieving that intended purpose or object.
27. Under the law as enacted, a business owner proposing a business restructure involving depreciating assets may be exposed to unintended adverse tax consequences. To avoid that outcome, the business owner has the choice of either excluding depreciating assets from the overall restructure or ensuring that depreciating assets are transferred at their market value.
28. Each of those alternatives limits the utility of the roll-over, increases the cost of undertaking the restructure (for example, by necessitating that market valuations be obtained) and can lead to additional ongoing compliance costs. The modification will increase the utility of the roll-over and will relieve affected businesses from unnecessary compliance costs.

Intended purpose or object of provision

29. The intended purpose or object of Subdivision 328-G is discussed earlier in this explanation (see paragraphs 21 to 25).

Compliance cost

30. The proposed exercise of the CRP will result in no or minimal impact for both implementation and ongoing compliance costs. The legislative instrument is minor or machinery in nature.

Budgetary impact

31. The Commissioner has received advice from the Department of the Treasury that the proposed exercise of the CRP would simply align the operation of the SBRR with policy intent and the revenue impact is expected to be negligible.

Consultation

32. Subsection 17(1) of the *Legislation Act 2003* requires, before the making of a determination, that the rule-maker is satisfied that appropriate and reasonably practicable consultation has been undertaken.
33. Broad consultation has been undertaken. The draft determination and draft explanatory statement were published on the ATO Legal database <http://www.ato.gov.au> seeking feedback and comments for a period of four weeks. Notice of the draft determination was also published on <http://www.ato.gov.au> and subscription alerts issued. Tax professionals and tax associations regularly review both the Legal database and <http://www.ato.gov.au> and further promulgate advice of new drafts issued in their internal news bulletins. The major legal publishers also publish news of the drafts in their key tax alerting services – such as the Weekly Tax Bulletin (published by Thomson Reuters Australia) and Tax Tracker and Tax Week (published by CCH Australia). Additionally, draft determinations and draft explanatory statements were published on the ATO Consultation Hub.
34. Public consultation resulted in one submission from a tax practitioner, who supported the use of the CRP to resolve this issue. At the suggestion of the stakeholder, minor amendments have been made to this Explanatory Statement to better explain the scope of the determination.
35. In addition, targeted consultation was undertaken with the CRP Panel, a body comprised of private sector specialists, Treasury and ATO representatives. This Panel provided feedback on the draft legislative instrument and explanatory statement.
36. The Board of Taxation was also consulted on the use of the CRP to resolve this issue, the draft legislative instrument and explanatory statement. The Board supported the CRP use.

Legislative references:

Human Rights (Parliamentary Scrutiny) Act 2011

Income Tax Assessment Act 1936

Income Tax Assessment Act 1997

Legislation Act 2003

Taxation Administration Act 1953

Tax and Superannuation Laws Amendment (2016 Measures No. 2) Act 2016

Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016

Statement of compatibility with Human Rights

This Legislative Instrument is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Taxation Administration (Remedial power –Small Business Restructure Roll-over) Determination 2017

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

This Legislative Instrument is made under section 370-5 of Schedule 1 to the *Taxation Administration Act 1953*. It modifies the operation of:

- (a) section 40-340 of the Income Tax Assessment Act 1997; and
- (b) any other provision of a taxation law the operation of which is affected by the operation of that section (as modified by this instrument) in relation to an asset covered by item 8 of the table in subsection 40-340(1) of that Act;

to ensure that the object of the *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016* can be better achieved. That is, to enable small businesses to transfer CGT assets, trading stock, depreciating assets, and revenue assets, as part of a 'genuine restructure of an ongoing business' without 'direct income tax consequences'.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.