client alert | explanatory memorandum

April 2016

CURRENCY:

This issue of **Client Alert** takes into account all developments up to and including 16 March 2016.

Deadline looming for SMSF collectables compliance

From 1 July 2011, self managed superannuation fund (SMSF) investments in collectables and personal-use assets have been subject to strict rules under Superannuation Industry (Supervision) Regulation (SIS Regulation) 13.18AA.

The ATO has reminded trustees of SMSFs that acquired such collectables or personal-use assets before 1 July 2011 that time is running out to ensure they meet the SIS Regulation requirements. Assets considered collectables and personal-use assets include artwork, jewellery, antiques, vehicles, boats and wine.

Investments in such items must be made for genuine retirement purposes and must not provide any present-day benefit. Under the rules:

- items cannot be leased to or used by a related party;
- items cannot be stored or displayed in a private residence of a related party;
- decisions about storage must be documented and the written records kept; and
- items must be insured in the fund's name within seven days of their acquisition.

In addition, if an item is transferred to a related party, a qualified independent valuation is required.

For investments held before 1 July 2011, SMSF trustees have until 1 July 2016 to comply with the rules. The ATO said trustees need to consider what actions are appropriate. Actions may include reviewing current leasing agreements, making decisions about storage and arranging insurance cover.

Trustees disposing of a collectable or personal-use asset can transfer it to a related party without a qualified independent valuation, but only if the transfer takes place before 1 July 2016 and the transaction is made on arm's-length terms.

As trustees have had since July 2011 to make appropriate arrangements, the ATO expects that they will ensure their SMSFs meet the requirements before the deadline.

Source: ATO media release, "Collectables – don't leave it too late!", 3 March 2016, https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/News/Collectables---don-t-leave-it-too-late/.

Overseas student debts: repayment thresholds

From 1 July 2017, anyone with a Higher Education Loan Programme (HELP) debt and/or a Trade Support Loans (TSL) debt who is living overseas and earning above the minimum repayment threshold will be required to make loan repayments, just as they would if they were living in Australia.

Repayment income and rates

A notice has been gazetted specifying the HELP repayment incomes and rates for the 2016–2017 financial year. The details are displayed in the following table.

HELP repayment thresholds and rates 2016–2017	
For repayment income in the range	**Percentage rate to be applied to repayment income**
Below $54,870	Nil
$54,870 to $61,120	4%
$61,121 to $67,369	4.5%
$67,370 to $70,910	5%
$70,911 to $76,223	5.5%
$76,224 to $82,551	6%
$82,552 to $86,895	6.5%
$86,896 to $95,627	7%
$95,628 to $101,900	7.5%
$101,901 and above	8%

Source: Commonwealth Gazette, "Notification of repayment incomes and repayment rates for the Higher Education Loan Program (HELP) for the 2016-17 income year", 1 March 2016 *https://www.legislation.gov.au/Details/C2016G00298*

ATO data-matching for insured "lifestyle" assets

In January 2016, the ATO advised it was working with insurance providers to identify policy owners on a wider range of asset classes, including marine vessels; aircraft; enthusiast motor vehicles; fine art; and thoroughbred horses.

The ATO has since gazetted a notice formally announcing the data-matching program. The ATO will acquire details of insurance policies for these assets where the value exceeds nominated thresholds for the 2013–2014 and 2014–2015 financial years. The asset thresholds are as follows:

- marine vessels: $100,000;
- aircraft: $150,000;
- enthusiast motor vehicles: $50,000;
- fine art: $100,000 per item; and
- thoroughbred horses: $65,000.

The ATO will obtain policyholder identification details (including names, addresses, phone numbers and dates of birth) and insurance policy details (including policy numbers, start and end dates, assets insured and physical locations of the assets). The data-matching program will assist the ATO with:

- profiling taxpayers (providing a more comprehensive view of a taxpayer's accumulated wealth);
- identifying possible compliance issues; for example:
  - asset betterment – taxpayers may be accumulating or improving assets but not including sufficient income in their taxation returns to show the financial means to pay for them;
  - income tax and capital gains – taxpayers may be disposing of assets and not declaring the revenue and/or capital gains on those disposals;
  - goods and services tax (GST) – taxpayers may be purchasing assets for personal use through businesses or related entities and claiming input tax credits they are not entitled to;
  - fringe benefits tax (FBT) – taxpayers may be purchasing assets through their business entities, but applying those assets to the personal enjoyment of an associate or employee, which gives rise to an FBT liability; and
  - superannuation – self managed superannuation funds (SMSFs) may be acquiring assets but applying them to the benefit of the fund's trustee or beneficiaries; and
- identifying avenues available to assist in debt management activities.

It is estimated that records of more than 100,000 insurance policies will be obtained. Further details, including the list of insurers participating in the data-matching program, are available on the ATO website at https://www.ato.gov.au/General/Gen/Lifestyle-Assets-Data-Matching-Program-Protocol/.
Source: Commonwealth Gazette, "Notice of Data Matching Program – Lifestyle Assets", 16 February 2016, https://www.legislation.gov.au/Details/C2016G00243.

Market value of shares is not the selling price

In a noteworthy decision, the AAT has ruled that the "market value" of a parcel of shares in a private company that a taxpayer sold in an arm's-length transaction (together with the other two shareholders' shares in the company) was not his proportion of the sale price received from the sale of all the shares, but a discounted amount. This caters for the fact that the market value of his shares alone as a "non-controlling" shareholder was a lesser amount. As a result, the taxpayer passed the $6 million "maximum net asset value" (MNAV) test for the purposes of qualifying for the capital gains tax (CGT) small business concessions, where otherwise he would not have.

Background

The taxpayer was one of three equal shareholders in a private company. The three shareholders sold their shares in the company for $17.7 million under a contract of sale to an arm's-length purchaser. The taxpayer was entitled to $5.9 million in respect of his one-third shareholding in the company. The issue for the AAT's consideration was whether the taxpayer passed the $6 million MNAV test. Taken together with the market value of the taxpayer's other assets, a market value of $5.9 million for the shares sold would mean the taxpayer failed the test.

The taxpayer drew the AAT's attention to the established test in *Spencer v The Commonwealth* [1907] HCA 82; (1907) 5 CLR 418 for determining the market value of an asset – namely, what "willing but not anxious parties" would be prepared to buy and sell the assets for. He argued that the market value of his shares was not necessarily equal to the amount paid by the arm's-length purchaser in his case, but was something less. The Commissioner, on the other hand, essentially argued that in an arm's-length transaction the market value of an asset was its selling price.

Decision

The AAT first noted that it is often the case, but not always, that the actual selling price of an asset at a particular time represents its "market value" just before that time. Therefore, it would be entirely "uncontroversial" to find that the market value of an asset in an arm's-length transaction is its actual selling price – provided that the parties were "willing and not anxious" and the subject matter of the contract was identical to the property whose "market value" needed to be determined.

However, the AAT found that was not true in this case, as the subject matter of the sale agreement was the entire 300 shares in the company, giving the buyer "complete control of the company, which the sale of [the taxpayer's] shares alone would not have done". The AAT recognised the relative lack of control enjoyed by the taxpayer as a result of his owning only one-third of the total shares in the company, and therefore agreed with his valuer's application of a discount to the taxpayer's one-third share of the total capital proceeds received for the sale of all the shares.

As a result, the AAT ruled that "the correct enquiry is directed towards determining the market value of the taxpayer's shares alone – not as part of a package comprising the entire 300 shares in the company". It found that the consideration the taxpayer received for his shares was more than a hypothetical "willing but not anxious" purchaser would have paid if purchasing the taxpayer's shares alone.

The AAT concluded that the actual consideration the taxpayer received should not be ignored as an indicator of the market value of his shares just before the time of the CGT event, but it was not determinative of that market value. In these circumstances, the AAT agreed that the market value of the taxpayer's shares was $5.9 million less a 16.7% discount for the "lack of control" factor. This decision meant that the taxpayer passed the $6 million MNAV test for the purposes of qualifying for the CGT small business concessions, where otherwise he would not have.

Appeal

The Commissioner has appealed to the Federal Court against this AAT decision.

Re Miley and FCT [2016] AATA 73, AAT, File No 2013/6008, 2013/6009, Frost DP, 15 February 2016, http://www.austlii.edu.au/au/cases/cth/AATA/2016/73.html.

Individual not a share trader

The AAT has found that a taxpayer was not carrying on a business of share trading, and accordingly was not entitled to claim a loss resulting from her share transactions.

Background

The taxpayer, a childcare worker, began trading shares during the 2011 income year. She incurred a $20,000 loss for the income year, which she sought to claim as a deduction. As a childcare worker, the taxpayer earned around $40,000 in the 2011 income year. In contrast, she turned over approximately $600,000 in share transactions (including both purchases and sales) for that income year.

The taxpayer told the Commissioner that she usually spent five to 10 hours per week conducting research and share trading, although she later altered this information, saying it was approximately 15 to 25 hours weekly. The taxpayer's oral evidence before the AAT demonstrated that she had very little knowledge of the companies she had invested in, as she was unable to list many of the names of the "blue chip" companies in which she had purchased shares or to recall what industries they operated in. Furthermore, the AAT noted that the single-paged business plan the taxpayer produced (which was not previously shown to the Commissioner) was written for the tribunal proceedings and did not exist in the 2011 income year.

Decision

In deciding that the taxpayer was a share investor and not a share trader, the AAT considered each of the key indicators established in case law, in particular those listed in *AAT Case 6297* (1990) 21 ATR 3747. The AAT decided that a lack of regular and systematic trade, especially in the second half of the 2011 income year – when only 10 transactions were made – went against the taxpayer's contention that she was conducting a share trading business.

It was more likely, the AAT said, that the taxpayer was only spending the originally purported five hours per week on researching and trading stock. Furthermore, the AAT found that the taxpayer's methods of research (eg reading financial newspapers) lacked the "sophistication to constitute a share trading business". In particular, the taxpayer lacked the knowledge and experience to trade in shares, and was likely relying on her husband's advice. While the AAT did concede that the capital involved in the taxpayer's transactions was substantial, it noted that this could indicate either share investment or a business of share trading. Accordingly, as the relevant factors weighed against the taxpayer, the AAT affirmed the Commissioner's decision to treat her as a share investor and to deny a deduction for her losses.

Re Devi and FCT [2016] AATA 67, AAT, File No 2014/4297, Lazanas SM, 9 February 2016, http://www.austlii.edu.au/au/cases/cth/AATA/2016/67.html.

Small business restructures made easier

The *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016*, passed on 8 March 2016, amends ITAA 1997 to provide an optional rollover for small business owners who change the legal structure of their business on the transfer of business assets from one entity to another (new Subdiv 328-G). The effect of the rollover is that the tax cost of transferred assets is rolled over from the transferor to the transferee.

This is in addition to existing rollovers which are available where an individual, trustee, or partner transfers assets to, or creates assets in, a company in the course of incorporating their business.

Eligibility

The new optional rollover will be available where a small business entity transfers an active asset of the business to another small business entity as part of a genuine business restructure, without changing the ultimate economic ownership of the asset.

The rollover applies to gains and losses arising from the transfer of active assets that are capital gains tax (CGT) assets, depreciating assets, trading stock or revenue assets between entities as part of a genuine restructure of an ongoing business.

Genuine restructure

The transfer of the assets must be part of a "genuine" restructure of an ongoing business (as opposed to an "inappropriately tax-driven scheme").

Whether a restructure is "genuine" will be determined with regard to all of the facts and circumstances. Relevant matters include whether it is a bona fide commercial arrangement undertaken to enhance business efficiency, whether the transferred assets continue to be used in the business and whether the restructure is a preliminary step to facilitate the economic realisation of assets.

A "safe harbour" rule provides that the restructure is "genuine" for three years after the rollover if there is no change in the ultimate economic ownership of any of the significant assets of the business (other than trading stock); those significant assets continue to be active assets; and there is no significant or material use of those significant assets for private purposes.

Entities that can access the rollover

To be eligible for the rollover, each party to the transfer must be:

- a small business entity for the income year during which the transfer occurred;
- an entity that has an affiliate that is a small business entity for that income year;
- connected with an entity that is a small business entity for that income year; or
- a partner in a partnership that is a small business entity for that income year.

"Small business entity" takes its usual meaning, as defined in Subdiv 328-C of ITAA 1997.

The rollover also applies to "passively held" assets of a small business that may, for example, be held in an entity other than the one carrying on the business (eg an affiliate or a connected entity that is a small business entity).

Ultimate economic ownership

The transfer must not have the effect of changing the ultimate economic ownership of transferred assets in a material way. The ultimate economic owners of an asset are the individuals who, directly or indirectly, beneficially own an asset. Ultimate economic ownership of an asset can only be held by natural persons. Therefore, where a company, partnership or fixed trust owns an asset, the natural person owners of the interests in these interposed entities will ultimately benefit economically from that asset.

If more than one individual is an ultimate economic owner of an asset, there is an additional requirement that each of the individuals' shares of that ultimate economic ownership be materially unchanged, maintaining the same proportionate ownership in the asset.

Discretionary trusts may be able to meet the requirements for ultimate economic ownership "on their facts"; for example, where there is no practical change in which individuals economically benefit from the assets before and after the rollover, there will not be a change in ultimate economic ownership on the facts.

Otherwise, a discretionary trust may meet an alternative ultimate economic ownership test, whereby every individual who had ultimate economic ownership of the transferred asset before the transfer and every individual who has ultimate economic ownership of the transferred asset after the transfer must be members of the family group relating to the family trust.

Eligible assets

Where a party to the transfer is itself a small business entity, the asset being transferred must be a CGT asset that is "active" (as defined in s 152-40).

Where a party to the transaction is an affiliate or connected entity with a small business entity, the asset must be an active asset that satisfies s 152-10(1A). Among other things, this requires that the relevant small business entity carries on business in relation to the asset.

Where a party to the transaction is not a small business entity, but is a partner in a partnership that is a small business entity, the asset must be an active asset and an interest in the asset of the partnership.

Other

Both the transferor and the transferee of the assets must be residents of Australia. The transferor and transferee must both choose to apply the rollover. The rollover will not apply for a transfer to or from an exempt entity or complying superannuation entity.

Effect of the roll-over

The rollover provides for tax-neutral consequences by "switching off" the application of the existing income tax law – but only for the purpose of the transfer, and not for the purposes of goods and services tax (GST), fringe benefits tax (FBT) or stamp duty.

The rollover provides that the transfer takes place for the asset's "rollover cost" – which is the transferor's cost of the asset for income tax purposes, such that the transfer would result in no gain or loss for the transferor. The transferee will be taken to have acquired each asset for an amount that equals the transferor's cost just before the transfer.

CGT assets

For the transfer of a CGT asset, the tax law will apply under the rollover as if the asset had been transferred for an amount equal to the cost base of the asset. Further, pre-CGT assets transferred under the rollover will retain their pre-CGT status in the hands of the transferee.

In respect of the availability of the CGT discount to the transferee, the period of eligibility for the CGT discount will recommence from the time of the transfer.

Trading stock

Assets that are trading stock of the transferor will be held as trading stock by the transferee. The transferee will inherit the transferor's cost and other attributes of the assets as the transferor just before the transfer.

To the extent that the asset is trading stock of the transferor, the rollover cost will be the cost of the item for the transferor at the time of the transfer; or, if the transferor held the item as trading stock at the start of the income year, the value of the item for the transferor at that time.

Revenue assets

The rollover cost is the amount that would result in the transferor not making a profit or loss on the transfer. The transferee will inherit the same cost attributes as the transferor just before the transfer.

Depreciating assets

Rollover relief will be available for depreciating assets (under s 40-340) where a rollover under the new measures would be available if the asset were not a depreciating asset. As a result, the transferee can deduct the decline in value of the depreciating asset using the same method and effective life as the transferor used.

Membership interests

Where membership interests are issued in consideration for the transfer of an asset, the cost base of those new membership interests is worked out based on the sum of the rollover costs and adjustable values of the rollover assets, less any liabilities that the transferee undertakes to discharge in respect of those assets, divided by the number of new membership interests.

The rollover does not require that market value consideration, or any consideration, be given in exchange for the transferred assets.

However, an integrity rule ensures that a capital loss on any direct or indirect membership interest in the transferor or transferee that is made subsequent to the rollover will be disregarded, except to the extent that the taxpayer can demonstrate that the loss is reasonably attributable to something other than the rollover transaction. This rule also applies where a transfer of value from an entity results in the creation of tax losses on later disposal of the membership interests.

It is important to note that in particular cases, restructuring to obtain timing advantages or other significant tax benefits in relation to membership interests and other interests in the entities involved in the transaction may mean that the “genuine “ restructure requirement is failed.

Small business concessions

Where the transferor has previously chosen to apply a small business rollover under Subdiv 152-E and a replacement asset is transferred under this rollover, the transferee is taken to have made the choice for the purposes of CGT events J2, J5 and J6.

For the purpose of determining eligibility for the 15-year CGT exemption for small businesses, the transferee will be taken as having acquired the asset when the transferor acquired it.

Date of effect

The amendments apply to:

- transfers of depreciating assets, where the balancing adjustment event arising from the transfer occurs on or after 1 July 2016;
- transfers of trading stock or revenue assets, where the transfer occurs on or after 1 July 2016; and
- transfers of CGT assets, where the CGT event arising from the transfer occurs on or after 1 July 2016.

Source: Tax Laws Amendment (Small Business Restructure Roll-over) Bill 2016, *http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5606%20Recstruct%3Abillhome.*

Tax law changes to treatment of earnouts

The *Tax and Superannuation Laws Amendment (2015 Measures No 6) Act 2016*, passed on 25 February 2016, amends ITAA 1997 to change the capital gains tax (CGT) treatment of the sale and purchase of businesses involving certain earnout rights. As a result, capital gains and losses arising in respect of look-through earnout rights will be disregarded. Instead, payments received or paid under the earnout arrangements will affect the capital proceeds and cost base of the underlying asset or assets to which the earnout arrangement relates when they are received or paid (as the case may be).

The Act also amends the rules relating to amendments to assessments, interest charges, recognition of capital losses and access to CGT concessions. This is to ensure the new treatment provides taxpayers with outcomes consistent with those had the value of all of the financial benefits under the earnout right been included in the capital proceeds from the disposal of the underlying asset for the seller and the cost base of the underlying asset for the buyer at the time of the disposal.

Changes from the draft Bill

The Act as passed is essentially the same as the original draft legislation. However, the following changes are notable:

- Financial benefits must be provided within five years in order to qualify as an “eligible” earnout arrangement. This was extended from the four-year period in the draft.
- It was unclear under the draft legislation how the measures would interact with the rules for accessing the CGT small business concession via the maximum net asset value test and, in particular, whether this would be determined only at the time of disposal without regard to any future potential future financial benefits to be provided. However, under the Act, taxpayers can elect to take into account any future financial benefits for this purpose.
- The Act explains in detail how the earnout measures will interact with the new “foreign resident CGT withholding” measures (also introduced in the Act).

Look-through earnout rights

A look-through earnout right is a right to future financial benefits which are not reasonably ascertainable at the time the right is created. The right must be created under an arrangement involving the disposal of a CGT asset that is an “active asset” of the seller, and the financial benefits under the right must be contingent on and reasonably related to the future economic performance of the asset (or a related business). As a result, a look-through earnout right must be created as part of an arrangement for a disposal of the business or its assets (ie the disposal must cause CGT event A1 to happen).

A right will also be a look-through earnout right if it is a right to receive financial benefits provided in exchange for ending a right that is a look-through earnout right.

For these purposes, an “active asset” is an asset of the taxpayer used in the taxpayer’s business or a “connected” or “affiliated” entity. The definition allows interests in foreign entities to be active assets for the purpose of this measure.

A membership interest in an Australian resident company or trust will also be an active asset if at least 80% of the assets of the company or trust (by value) are active assets. However, special rules apply in this case: if, for example, the sole asset of Company A is a share in Company B, which itself only holds a share in Company C, the character of interests in both A and B will depend on the character of the assets of C.

Further, in determining if such interests are active assets, the amendments provide that an eligible share or an interest in a trust is treated as an active asset in the hands of an entity for the purpose of determining if a look-through earnout right exists. For these purposes, the entity holding the share or interest must either:

- if they are an individual – be a CGT concession stakeholder in relation to the company or trust; or
- if they are not an individual – own a sufficient share of the business that they would be a CGT concession stakeholder were they an individual.

In addition, the trust or company must carry on a business and have done so for at least one prior income year, and at least 80% of the assessable income of the trust or company for the immediately preceding income year must have come from the carrying-on of a business (not derived as an annuity, interest, rent, royalties or foreign exchange gains, or derived from or in relation to financial instruments). Importantly, this test allows taxpayers to avoid having to value the assets of the trust or company. Instead, they need only look at how the trust or company earned its income over the past income year.

It is important to note that look-through earnout rights must be created as part of arrangements entered into on an arm’s-length basis. The look-through measures are not intended to provide tax benefits to temporary transfers (such as a loan or granting of a lease), ongoing business relationships (such as the purchase of an ownership interest) or complex financing arrangements where there is no final disposal of the underlying asset.

Contingent on the future economic performance of the asset

To be a look-through earnout right, the future financial benefits provided under that right must be linked to the future economic performance of the asset or a business in which the asset is used and not reasonably ascertainable at the time the right is created. Where the measure of performance relates to a business, there must be a reasonable belief at the time of disposal that the asset will actually be used in this business. In the case of the entity disposing of the asset, this will be based on what is reasonable given their knowledge of the intention of the other party.

Whether a particular measure appropriately identifies economic performance will depend on the context of the business or asset in question. Measures that may be appropriate include financial measures such as the profit, sales or turnover of the business (or the business in which the asset is used), and non-financial measures such as the number of clients retained. However, any measure adopted must be reasonable in the particular context. For a right to be a look-through earnout right, the value of the benefits must also reasonably relate to the performance.

Five-year payment limitation

For a right to be a look-through earnout right, it must not require financial benefits to be provided more than five years after the end of the income year in which the relevant CGT event occurs in relation to disposal of the relevant active asset. This ensures concessions for look-through earnout rights are not available to long-term profit-sharing arrangements and avoids providing an excessive and distorting benefit to look-through earnout rights.

However, this requirement is not breached simply because one party or another may be late in providing a financial benefit under the look-through right, even if the other party tolerates this lateness. It will also not be breached if the agreement includes provisions that allow for a delay in payment contingent on events, such as a dispute over the terms of the agreement being subject to a binding arbitration process. The relevant contingency must be outside the control of either party.

The five-year requirement will be breached if the agreement includes an option for the parties to extend the period over which financial benefits are provided, or to enter into a new agreement providing for continuation of substantially similar financial benefit. Further, the right will be taken to have never been a look-through earnout right if the parties vary the right to extend the period over which financial benefits are provided beyond five years or enter into a new agreement to create an equivalent right to further future financial benefits.

Consequences of a right being a look-through earnout right

If a right is a look-through earnout right, the value of the right is disregarded for the purposes of CGT, and the value of any financial benefits made or received under the right is included in either the capital proceeds arising from the disposal (for the seller) or the cost base of the acquisition (for the buyer). Accordingly, any capital gain or loss arising in respect of the creation or cessation of a look-through earnout right will be disregarded.

Similarly, the value of a look-through earnout right will not be taken into account in determining the capital proceeds of the disposal of the active asset for the seller, nor the cost base and reduced cost base of the asset acquired by the buyer. Instead, the value of any financial benefits subsequently provided or received under or in relation to such a right will be included in the original capital proceeds of the disposal for the related asset for the seller, or the initial cost base and reduced cost base of the asset for the buyer as at the date of the original acquisition.

However, where a taxpayer subsequently disposes of an asset that is subject to an ongoing look-through earnout right before their obligations or entitlements in relation to financial benefits under the right are exhausted, their cost base for the asset may change as a result of any subsequent financial benefits they pay or receive. In this situation, the taxpayer will need to adjust the capital gain or loss on that subsequent disposal.

Choices and timing

This treatment of earnout rights results in the amount of a capital gain or loss changing because of financial benefits provided or received in subsequent income years. A number of special rules are required to ensure that this does not disadvantage taxpayers or impose unnecessary compliance and administrative costs.

First, as the financial benefits may be provided up to five years after the end of the income year in which the CGT event occurred, the period of review for the income year in which the CGT event occurred may have passed before the taxpayer has provided or received the financial benefits requiring the amendment. Therefore, the period of review will be extended for all of a taxpayer's tax-related liabilities that can be affected by the character of the look-through earnout right to the later of (a) the period of review that would normally apply and (b) four years after the end of the final income year in which financial benefits could be provided.

Importantly, this period of review extension includes liabilities in subsequent years for taxes other than income tax. For example, the small business CGT retirement concessions provide, broadly, that certain contributions to superannuation linked to capital gains arising from the sale of business assets do not count towards non-concessional superannuation contribution caps. If the amount of the relevant gain for a taxpayer changes as a result of the financial benefits provided under an earnout right, the extended amendment period would apply to the assessment of the taxpayer's non-concessional contributions.

This extension also applies to a taxpayer's right to object where they are dissatisfied with an assessment.

Second, where the amount of a gain or loss may substantially vary from the amount of the gain or loss identified in the year in an uncertain way, the amendments will permit taxpayers to amend a choice made previously in relation to a capital gain or loss that can be affected by financial benefits provided under a look-through earnout right. However, the decision to vary a choice must be made by the time the taxpayer is required to lodge a tax return for the period in which the financial benefits under the look-through earnout right is received.

Third, in relation to the imposition of the general interest charge (GIC), taxpayers will not be subject to interest on any shortfall that arises as a consequence of financial benefits provided or received under a look-through earnout right, as long as they request an amendment to their relevant income tax assessment within the lodgment period for their income return for the year in which the financial benefit was provided or received. (Likewise, the Commissioner will not be liable to pay interest on any tax overpayment that arises as a result of financial benefits provided or received.)

However, the taxpayer will be subject to the shortfall interest charge (SIC) to the extent they have accessed a concession for which they are ultimately not eligible due to these financial benefits.

Finally, in cases where entities dispose of assets and receive a look-through earnout right that initially results in a capital loss position, such capital losses will be "temporarily disregarded" until and to the extent that they become certain. Once such losses become certain, they will be available from the year in which the loss was originally incurred, not when the amount became certain.

Access to CGT concessions

The changes to the treatment of look-through earnout rights are only intended to affect a taxpayer's entitlement to CGT concessions insofar as this may occur because of the underlying disposal value, including all of the amounts provided for and under the earnout right. Taxpayers may reconsider any choices and their entitlement to concessions in light of subsequent receipts and payments to ensure that the resulting gain, loss or cost base reflects any concessions that are available.

Likewise, in some cases a taxpayer may not initially be in a position to elect that a concession apply to a CGT event. Alternatively, a taxpayer may be concerned that anticipated future financial benefits in respect of a look-through earnout right may mean they are not eligible for a concession after they have taken irrevocable actions based on this concession (such as making contributions to superannuation). In these cases, the taxpayer can now simply wait until it is clear whether they will be finally eligible for the concession before making any choice.

However, while the receipt of financial benefits under a look-through earnout right may allow the taxpayer to remake choices, it does not entitle them to undo actions they have taken in that period. For example, if a taxpayer has made contributions to superannuation in order to access a concession, they cannot withdraw these contributions if the concession is no longer available.

Further, the CGT small business concessions can require action within a fixed period of time. For example, the CGT small business retirement exemption generally requires taxpayers to contribute a relevant amount to their superannuation when the proceeds are received or at the time the choice is made for an individual, or within seven days for a trust or company. In such cases the period for accessing such concessions will be extended appropriately.

Access to CGT concessions: the MNAV test

The maximum net asset value (MNAV) test has been revised. When working out the value of an entity's CGT assets "just before the time of a CGT event", taxpayers should be able to elect not to include the value of any look-through earnout right the entity may hold, but instead to take into account any financial benefits that the entity may have provided or received under the look-through earnout right after that time. The election to use this method may only be made once no further financial benefits can be provided under the look-through earnout right.

Foreign resident CGT withholding and look-through earnout rights

Where relevant taxable Australian property under the foreign resident CGT withholding rules (contained in the Act) is an active asset of a business, it may also potentially be subject to a look-through earnout right as part of the sale. As a result, if a transaction to which foreign resident capital gains withholding applies involves a look-through earnout right, the taxpayer does not need to include any amount referable to the future financial benefits under the look-through earnout right.

Instead, if the original transaction required a purchaser to pay an amount to the Commissioner, the purchaser must also pay an amount with respect to any financial benefits provided under look-through earnout rights when the benefits are received. However, the purchaser must still pay 10% of the financial benefit to the Commissioner.

This obligation to withhold with respect to the original transaction may be relieved where there are changes in the residency circumstances of the person who ultimately receives the financial benefit. Alternatively, the financial benefit may be directed towards a person who was not a part of the original transaction. In either case, the question of whether the person receiving the benefit is a relevant foreign resident is reassessed at the time the financial benefit is provided or received.

Date of effect

These amendments apply from 24 April 2015. However, taxpayers who have made statements to the Commissioner and undertaken other actions in reasonable anticipation of announcements made about the amendments in the 2010–2011 Budget are protected against the Commissioner applying the law in a way that is inconsistent with what they have anticipated.

Source: Tax and Superannuation Laws Amendment (2015 Measures No 6) Bill 2015, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;page=0;query=BillId%3Ar5585%20Recstruct%3Abillhome.

ATO administrative treatment: non-qualifying rights

The ATO says that taxpayers who cannot satisfy the requirements of the law enacted on 25 February 2016 will need to apply the treatment detailed in Draft Taxation Ruling TR 2007/D10.

Source: ATO website, "Non-qualifying rights", 1 March 2016, https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-on-capital-gains/CGT--Look-through-treatment-for-earnout-rights/?page=2#Administrative_treatment.

Thomson Reuters would like to hear from you

Subscribers are invited to submit topics for articles for future publication. Information should be sent to:

Publisher – **Client Alert**

Thomson Reuters (Professional) Australia Limited ABN 64 058 914 668
PO Box 3502, Rozelle NSW 2039

Tel: 1800 074 333

Product Manager – Steven Jones

Email: SupportANZ@thomsonreuters.com

Website: www.thomsonreuters.com.au