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General value shifting regime

An overview document that contains summary information about the 'General value shifting regime'.

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- Key features
- Components
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- Control threshold tests

See also

- Guide to the general value shifting regime

Key features

Components

Consolidated groups

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Key features

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The general value shifting regime (GVSR) replaced the previous value shifting rules contained in Divisions 138, 139, and 140 of the *Income Tax Assessment Act 1997* (ITAA 1997), generally with effect from 1 July 2002.

The regime addresses arrangements that shift value out of assets, distorting the relationship between their market values and their values for tax purposes. Without a value shifting regime, these arrangements could encourage the creation of artificial losses and the deferring of gains.

The previous value shifting rules:

- did not apply comprehensively (for example, they applied to shares in a company but not to interests in a trust)
- did not contain adequate small value exclusions or safe harbours to ease compliance
- resulted in unintended consequences in some instances.

The *Review of Business Taxation – A Tax System Redesigned* (1999) recommended introducing the GVSR to address these deficiencies and to improve the overall integrity of the tax system. The regime achieves these objectives by ensuring broadly consistent treatment for comparable value shifts across different types of entities and dealings.

Start date

The GVSR applies to entities from 1 July 2002 (including those with substituted accounting periods). The previous value shifting rules contained in Divisions 138, 139 and 140 of the ITAA 1997 do not apply to any schemes entered into on or after that date.

The GVSR may also apply where a scheme is entered into on or after 27 June 2002 and the value shift happens after 30 June 2002.

Exclusions

Small value exclusions ensure the GVSR is targeted at substantial value shifts. As a result, many businesses will not be affected by the regime, and those that are will have smaller compliance costs than if all value shifts had to be identified.

The small value exclusions are:

- entity interest direct value shifting rules (total value shifts under a scheme are less than $150,000)
- created rights direct value shifting rules (the market value of the right granted exceeds the proceeds for the grant by $50,000 or less)
- indirect value shifting rules (total value shifted is equal to or less than $50,000).

There are several exclusions and safe harbours in the indirect value shifting rules. For example, an entity that is a small business entity, or an entity that satisfies the 'maximum net asset value test' will not be required to make any adjustments under the indirect value shifting rules.

There are safe harbours to ensure the rules do not affect assets transferred at cost (in most cases), and most value shifts relating to services are excluded unless they are significant in size.

A 'realisation time method' of making adjustments is also available under the indirect value shifting rules, and value shifts of less than $500,000 that happen more than 4 years before realisation of certain interests can be disregarded.

When the regime does not apply

You can make sure the GVSR does not apply by ensuring:

- equity and loan interests in entities are issued at market value
- rights over any underlying asset are granted for full market value consideration
- entities provide economic benefits to each other at market value or otherwise deal at arm's length.

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Components

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The general value shifting regime (GVSR) has three components:

1. Direct value shifting rules for entity interests.
2. Direct value shifting rules for created rights.
3. Indirect value shifting rules.

The direct value shifting rules apply to assets that are directly affected by a value shift. Broadly, a direct value shift happens where something is done that results in the market value of an asset decreasing, usually with a resulting increase in the market value of another asset.

Examples of direct value shifts are where share rights are varied for one class of shares but not another, or where an owner of an asset grants a right of use to another entity for no payment.

Such value shifts distort the relationship between the asset's market value and the asset's value for tax purposes. The direct value shifting rules seek to address this distortion.

The indirect value shifting rules apply to interests in entities that have value shifted to or from them resulting in an indirect effect on the value of the interests.

Entity interest direct value shifting rules

Created rights direct value shifting rules

Indirect value shifting rules

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Entity interest direct value shifting rules

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Broadly, the entity interest direct value shifting rules apply where a scheme effectively results in a value shift between equity or loan interests in a company or trust that is controlled (for value shifting purposes) by another entity.

Such value shifts include the issue of interests in a company or trust at a discount to market value (shifting value out of existing interests) or the variation of rights attaching to a class of existing interests in a company or trust (for example, shifting value out of that class and increasing the value of another class).

Interests issued for more than market value do not trigger the rules (but existing capital gains tax rules may limit the first element of cost base and reduced cost base of the interests to market value).

The entity interest direct value shifting rules generally nullify the effect of a value shift by adjusting the tax values of certain equity and loan interests in the company or trust. These are interests that are owned by:

- the controller
- their associates
- associates of associates
- for closely held entities, by active participants in the scheme.

However, in some instances, the rules may treat the value shift as if it were a partial realisation of the interests from which the value was shifted, possibly resulting in an assessable gain. It cannot result in a loss. The tax values of interests are adjusted to reflect this treatment.

Example: entity interest direct value shift

Example: entity interest direct value shift

- 'Controller' holds all 10 'A class' shares on issue in 'Venture Co'. These shares have a market value of $1 million each. 'Associate' holds all 10 'B class' shares in the same company. These shares have a market value of $200,000 each.
- Controller and Associate agree to vary the rights attaching to both classes of share. This results in the market value of the A class shares decreasing by $200,000 each, and the market value of the B class shares increasing by $200,000 each.
- There has been a value shift of $2 million from Controller's shares to Associate's shares to which the entity interest direct value shifting rules may apply.
- Controller may make an assessable gain depending on the tax value of the A class shares and, in any case, tax value adjustments for the A class and B class shares may be required.

See also

- Section 2 of the Guide to the general value shifting regime

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Created rights direct value shifting rules

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Broadly, the created rights direct value shifting rules can apply where a right is created out of, or over, an asset for less than market value in favour of an associate, and the underlying asset is later realised at a loss while the right still exists.

The creation of the right distorts the relationship between the market value of the underlying asset and the value of that asset for tax purposes.

The created rights direct value shifting rules address the effect of the value shift by reducing the amount of any loss on realisation of the underlying asset. The rules do not apply to:

- depreciating assets
- conservation covenants
- testamentary estates.

Example: created rights direct value shift

Example: created rights direct value shift

- 'Black Co' owns 'Whiteacre', a property with a cost base of $10 million and a market value of $14 million. Black Co grants to 'Black Trust' (an associate) a 20-year lease for $100 premium and no rental. The market value of the lease when granted is $6 million.
- The grant of the lease reduces the market value of Whiteacre by $6 million (to $8 million). Immediately after the grant of the lease, Black Co sells Whiteacre for $8 million.
- The created rights direct value shifting rules may apply to this arrangement to prevent a $2 million capital loss on disposal of Whiteacre.

See also

- Section 3 of the Guide to the general value shifting regime.

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Indirect value shifting rules

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Generally, an indirect value shift happens when entities that are not dealing at arm's length engage in a non-market value transaction.

The value shifting effect is referred to as 'indirect' because it affects the values of interests held in those entities. Such value shifts distort the relationship between the market value of the interests and their values for tax purposes.

The indirect value shifting rules seek to address this distortion.

The rules can affect equity and loan interests in the losing or gaining entity for an indirect value shift where those entities are commonly controlled or commonly owned.

A losing entity is a company or trust that loses value because of the shift. A gaining entity gains value. The rules nullify the effect of the value shift by making adjustments to either:

- the value of the interests for tax purposes just before the time of the value shift
- losses or gains arising when those interests are realised.

Example: indirect value shift

Example: indirect value shift

- 'Pinnacle Co' controls (for value shifting purposes) 'A Co' and 'B Trust'.
- A Co transfers an asset with a market value of $1 million to B Trust in exchange for a single cash payment of $300,000 in a non-arm's length dealing.
- The indirect value shifting rules may apply either to
  - adjust the values for tax purposes of Pinnacle Co's interests in A Co and B Trust because of this arrangement
  - reduce any loss Pinnacle Co may make on subsequently realising interests in A Co, or reduce any gain it may make on realising interests in B Trust.

The indirect value shifting rules do not impact on the underlying transaction that causes the value shift (that is, the transfer of the asset from 'A Co' to 'B Trust'). The tax treatment of that transaction is determined under the general capital gains tax rules and income rules.

See also

- Section 4 of the Guide to the general value shifting regime

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Consolidated groups

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The single entity rule means:

- the general value shifting regime (GVSR) has no impact for equity and loan interests of one group member in another within consolidated and multiple entry consolidated (MEC) groups during consolidation
- subsidiary members of a consolidated or MEC group are treated, for certain purposes, as parts of a head company rather than as separate entities for income tax purposes.

Value shifts between group members are addressed by the leaving tax cost reconstruction rules for such interests.

Interests held by non-group members in a consolidated or MEC group, and interests held by consolidated or MEC group members in non-group members, are potentially subject to the GVSR (or the new 'loss reduction method').

Example: consolidation and value shifting

Example: consolidation and value shifting

- 'Ball Co' is the head company of a consolidated group including subsidiary members 'Bat Co' and 'Stump Co'. Ball Co also has an interest (90%) in 'Violin Co' (non-group member).
- The GVSR has no application to the transfer of an asset from Stump Co to Bat Co at less than market value. The tax cost of Ball Co's shares in Stump Co or Bat Co are reconstructed on the basis of the assets in the company when it leaves the group under the consolidation rules.
- Special rules (the loss reduction method) may also apply to prevent a loss made on a loan by Violin Co to Stump Co unless

the loss could be shown to be attributable to something other than losses or indirect value shifts involving the group.

- However, the normal rules may apply where an asset is transferred from Violin Co to a consolidated group member for less than market value. Ball Co's shares in Violin Co (not being a group member) are not subject to consolidation reconstruction rules, but could be affected by the indirect value shifting rules.

See also

- Section 5 of the Guide to the general value shifting regime

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Control threshold tests

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Control threshold tests are an important feature of the general value shifting regime. They ensure the rules are properly targeted at entities (affected owners) that can shape the transactions that create the value shift, or that are related to such entities.

If a value shift affects an asset or interest held by an entity that is not within this framework, any increase or decrease in its value is treated as a windfall for which there are no consequences under the regime.

Control tests:

- are relevant for the entity interest direct value shifting rules and the indirect value shifting rules
- are **not** relevant to the created rights direct value shifting rules.

See also

- Section 6 of the Guide to the general value shifting regime
- General value shifting regime
  - who it affects
  - comprehensive guide

- Visit the **General value shifting regime** homepage

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