LCG 2016/2 - Small Business Restructure Roll-over: consequences of a roll-over

Australian Government
Australian Taxation Office

Law Companion Guideline
LCG 2016/2

Page status: **legally binding**

Small Business Restructure Roll-over: consequences of a roll-over

Relying on this Guideline

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

This Guideline describes how the Commissioner will apply the law as amended by the *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016* to entities that rely on this Guideline in good faith.

If you rely on this Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters covered by the Guideline if it does not correctly state how a relevant provision applies to you.

Table of Contents **Paragraph**

What this Guideline is about

1. This Guideline explains the income tax 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).[1]

2. The Guideline applies only where the requirements for the SBRR set out in section 328-430 are satisfied. We recommend reading this Guideline together with Law Companion Guideline LCG 2016/3 *Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters.*

Date of effect

3. This Guideline applies to transfers that occur on or after 1 July 2016 which involve:

- a balancing adjustment event for a depreciating asset
- trading stock or a revenue asset, or
- a capital gains tax (CGT) event in respect of a CGT asset (that is not a depreciating asset, trading stock or revenue asset).

Background

4. The SBRR assists small business owners to undertake genuine restructures[2] of their businesses which alter the way assets used in their businesses are held.

5. The measure affects what gains or losses the transferor recognises, the carrying tax values for the transferee, and what subsequent losses on membership interests can be recognised.

5A The SBRR does not affect other tax liabilities (for example, fringe benefits tax or goods and services tax), or prevent any liability for stamp duty from arising under State legislation. Existing obligations under other regulatory regimes, such as the corporations law, must still be complied with. Furthermore, care should be taken that any transactions involving a trust are within the power or duties of the trustee. The following examples are provided to illustrate these consequences.

[1] Unless otherwise indicated, all legislative references in this Guideline are to the ITAA 1997 as amended by the *Tax Law Amendment (Small Business Restructure Roll-over) Act 2016.*
[2] Refer to LCG 2016/3.

Example 1 – Restructure from company to discretionary trust

Facts

6. Pep and Sally, a married couple, are the directors and shareholders in Vitamin Pty Ltd, which has issued two shares for total contributed capital of $100. Each share has a cost base of $50. Vitamin Pty Ltd carries on a naturopathy business.

7. As at 1 January 2017, the active assets of the company are:

- a small consulting room, which was acquired by Vitamin Pty Ltd for $200,000 in 2010
  - no other additional capital expenditure has been outlaid in relation to the room
  - the market value is $230,000
- a pill press, with an adjustable value of $14,000
- goodwill, which is self-generated, and
- 50 bottles of homeopathic pills, which were made and processed by Pep and Sally, and became Vitamin Pty Ltd's trading stock during the current income year at a cost of $250.

8. The liabilities of the company, arising from a debt for unpaid income tax and trade creditors, total $24,000.

9. A new discretionary trust, the P&S Trust, is settled and family trust election is made with Pep as the primary individual.[3]

10. On 1 January 2017, Pep and Sally cause Vitamin Pty Ltd to transfer all[4] of its assets (except petty cash[4A]) to the trustee of the P&S Trust (the trustee) in consideration for the trustee undertaking to discharge Vitamin Pty Ltd's liabilities. The company and the trustee choose to apply the SBRR.

No direct income tax consequences from the transfer of assets

11. Under the SBRR, a transfer of an asset has no direct income tax consequences, except as provided for under Subdivision 328-G.[5] Related roll-over relief for depreciating assets is available under section 40-340. Most importantly, this means:

- No capital gain or loss arises from the transfer of the consulting room or goodwill.
- No amount is included in Vitamin Pty Ltd's assessable income, or deduction allowed, as a result of a balancing adjustment event under Division 40 (capital allowances) for the transfer of the pill pressing machine.
- As a result of the disposal of the pills to the trustee, Vitamin Pty Ltd is taken to have transferred the pills for their cost ($250) and not for their market value. Vitamin Pty Ltd includes $250 in its assessable income under section 70-90.[6]

---

[3] Refer to Subdivision 272-D of Schedule 2F to *Income Tax Assessment Act 1936* (ITAA 1936).

[4] Goodwill is something which attaches to a business and cannot be dealt with separately from the business with which it is associated. Accordingly, if a business owner disposes of their entire business, goodwill may be transferred with that business.

[4A] See paragraph 328-430(1)(d).

[5] Section 328-450.

[6] This neutralises the deduction that Vitamin Pty Ltd otherwise claims for the cost of the pills ($250).

- No dividend arises as a result of the transfer of CGT assets (that are not depreciating assets[6A]) by Vitamin Pty Ltd (including any 'deemed dividend' under Division 7A of Part III of the ITAA 1936 or any other provision of the tax law).

12. Vitamin Pty Ltd recognises any tax liability that may arise under another Commonwealth taxing statute (for example, fringe benefit tax or goods and services tax) or any liability for stamp duty under State legislation.

Setting the tax values of the transferred assets in the hands of the transferee

13. The income tax law applies as if the transfer takes place for the asset's roll-over cost.[7]

14. The small consulting room is a CGT asset that is not a depreciating asset, revenue asset, or trading stock of Vitamin Pty Ltd.

- The trustee is taken to have acquired the consulting room at the time of the transfer for $200,000, being Vitamin Pty Ltd's cost base for the asset immediately before the transfer takes effect.[8]

15. The goodwill is a CGT asset that is not a depreciating asset, revenue asset or trading stock of Vitamin Pty Ltd.

- The trustee is taken to have acquired the goodwill at the time of the transfer for $0, being Vitamin's Pty Ltd's cost base for the goodwill immediately before the transfer takes effect.[9]

16. The pill press is a CGT asset that is a depreciating asset.

- The roll-over cost for a depreciating asset is the transferor's adjustable value just before the transfer takes effect.[10] The adjustable value is $14,000.
- The trustee's cost for the pill press is its adjustable value to Vitamin Pty Ltd just before the transfer ($14,000).
- The trustee can deduct the decline in value of the pill press using the same method and effective life (or remaining effective life, if using the prime cost method) as Vitamin Pty Ltd was using.[11]

17. The homeopathic pills are trading stock.

- The pills are trading stock on hand in the hands of the trustee.
- The roll-over cost for these pills is the cost of the item to Vitamin Pty Ltd ($250)[12], and is deductible.[13]

[6A] There is some uncertainty about whether or not a transfer of a depreciating asset under the SBRR will have direct consequences under the income tax law, notwithstanding section 328-450. As a matter of practical administration, the Commissioner will treat transfers of depreciating assets in the same way as other assets for the purposes of compliance with section 328-450.

[7] Subsection 328-455(1). The roll-over of a depreciating asset transferred in the restructuring of a small business is addressed in item 8 of the table in subsection 40-340(1). The transferee can deduct the decline in value of the depreciating asset using the same method and effective life that had been used by the transferor.

[8] Paragraph 328-455(2)(a).

[9] Paragraph 328-455(2)(a).

[10] See item 8 of subsection 40-340(1), subsection 40-345(2) and section 40-85.

[11] Subsection 40-345(2).

[12] Paragraph 328-455(2)(b).

[13] The trustee will need to account for either sales income or stock on hand at the end of the income year.

Acquisition times in the hands of the transferee are set

18. The general CGT acquisition rules apply[14], to determine whether any future capital gain made from a transferred asset is discounted under Subdivision 115-A (the general 50% CGT discount).

- This means, apart from pre-CGT assets, the transferee acquires the asset at the time of the transfer. That is, the time of acquisition is not altered by Subdivision 328-G.[15]

19. Following the transfer of assets to the trustee of the P&S trust, a property investor makes an attractive offer to the trustee for the consulting room.

20. On 30 September 2017, the trustee enters into an agreement for the sale of the consulting room. The trustee disposes of the room and CGT event A1 happens on 30 September 2017.

21. The trustee is treated as having acquired the CGT asset at the time of the SBRR transfer, on 1 January 2017.

22. The trustee is not entitled to access the 50% general CGT discount on disposal, as the trustee acquired the asset less than a year before the CGT event causing this gain.

23. However, 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.[16]

23A If Pep and Sally transferred their shares in Vitamin Pty Ltd to the trustee of the newly established P&S Trust, Pep and Sally would not be able to choose to apply the SBRR for those shares[16A]

Example 2 – Restructure from partnership to company – cost base of shares

Facts

24. Leon and Michelle carry on a car and tyre services business in a partnership.

25. The active assets of the business are a small suburban garage and goodwill. In 1980, Leon and Michelle acquired the real property (garage) for $80,000, a pre-CGT asset. After 19 September 1985, additional capital expenditure of $40,000 has been outlaid in relation to the garage as an improvement (and is a separate CGT asset[17]).

26. The liabilities of the business are provisions for employee entitlements totalling $20,000.

27. They decide to incorporate a new company, LM Services Pty Ltd, and subscribe for 100 original shares with a cost base of $1 each. They maintain the same proportionate ownership.

28. Leon and Michelle transfer all the assets to LM Services Pty Ltd. The company gives the following as consideration for the transfer of the assets:

- 10,000 newly issued ordinary shares
- assumption of the liabilities for employee entitlements, and
- $10,000 cash, borrowed from Leon and Michelle, in their capacity as shareholders.

[14] Paragraph 328-450(2)(b).
[15] Section 328-460.
[16] Subsection 152-115(3).
[16A] The shares are not active assets relevantly under paragraph 328-430(1)(d).
[17] Section 108-70.

29. Both the partnership and LM Services Pty Ltd elect for the SBRR to apply.

Tax values of any membership interests issued for the transfer are set

30. Generally, where membership interests are issued as consideration for the transfer, the cost base of each new membership interest is the sum of the tax values[17A] of the transferred assets less any liabilities that the transferee assumes, divided by the number of new membership interests.[18]

Step 1 – Tax values of assets

31. The sum of the roll-over costs excludes the roll-over costs of pre-CGT assets.[19] In this case, the sum is $40,000:

- the pre-CGT garage is $80,000, but the amount is excluded
- the improvements are $40,000, and
- the goodwill is $0.

Step 2 – Liabilities

32. The sum of any liabilities assumed is then subtracted from the sum of roll-over costs. In this case, LM Services Pty Ltd assumes[20] liabilities amounting to $20,000 for employee entitlements.

33. This means, the first element of the membership interests cost base is $20,000 ($40,000 − $20,000).

Step 3 – Consideration other than membership interests

34. Where the membership interests constitute only a part of the total consideration, the calculated sum[20A] needs to be reduced accordingly.[21] In this example, it needs to be reduced by $10,000:

- $10,000 cash was provided as part of the consideration for the transfer.

Step 4 – Cost base for new membership interest

35. The aggregate cost base of the new membership interests is therefore $10,000. This amount is then divided by the number of newly-issued ordinary shares (10,000) to determine that the cost base of each share is $1.

[17A] These are nil for pre-CGT assets, the adjustable value of depreciating assets and the roll-over cost for other assets.
[18] Section 328-465
[19] Subparagraph 328-465(1)(d)(i)
[20] Paragraph 328-465(1)(d)
[20A] Step 1 amount less Step 2 amount.
[21] Subsection 328-465(2)

Example 3 – Capital loss on shares attributable to transfer of asset

Facts

36. Tom carries on a business of selling vacuum cleaners and cleaning products as a sole trader. He runs his business from a shop that he rents from a company, Cohen Pty Ltd. Tom is the sole director and shareholder of Cohen Pty Ltd.

37. The cost base and reduced cost base of Tom's shares in Cohen Pty Ltd is $250,000. The cost base of the shop to Cohen Pty Ltd is $100,000.

38. Cohen Pty Ltd also holds a small office which it acquired recently for $150,000. Cohen Pty Ltd rents out the office to an independent third party, Mark, who uses it to carry out his accountancy business.

39. Using the SBRR, Tom (as director of Cohen Pty Ltd) decides to transfer the shop into a newly established trust for no consideration (who also elects for the SBRR to apply), leaving Cohen Pty Ltd with the office as its only asset.

Uneconomic losses that are attributable to the transfer are disregarded

40. There are no direct income tax consequences for Cohen Pty Ltd from the transfer of the shop.

41. Tom will not need to adjust the cost base of his shares in Cohen Pty Ltd to reflect the roll-over. However, if Tom later disposes of the shares for a loss, he will have to disregard the loss unless he can show that it was attributable to something other than the roll-over transaction.[22]

42. For example, if subsequent to the restructure Tom receives an unexpected offer from Mark to acquire the shares in Cohen Pty Ltd for $175,000 (reflecting the market value of the office), then Tom would need to disregard the capital loss that he would otherwise make on the shares.

43. This is because Tom's capital loss of $75,000 ($175,000 – $250,000) is wholly attributable to the transfer of the shop.

Example 4 – Transfer of assets that form a small business pool

Facts

44. Sue acquired an existing small business which provides dry cleaning, laundry, home pick-up and delivery services.

45. During the 2016 income year, Sue purchased new assets for the business for $60,000:

- a washer, a tumble dryer, and a dry cleaning machine totalling $10,000, and
- 2 delivery vans for $25,000 each, totalling $50,000.

46. Sue chooses to use the small business pool.[23] Using the pool, Sue deducted the business' depreciating assets on a diminishing value method and treated the assets in the pool as a single depreciating asset.

47. For the 2016 income year, Sue claimed a deduction of $17,500 for the pool ($7,500 for the delivery vans[24] and $10,000 for the rest of the depreciating assets[25]).

[22] Section 328-470.
[23] Subdivision 328-D.
[24] Section 328-190.
[25] Section 328-210 and subsection 328-180(6) of the *Income Tax (Transitional Provisions) Act 1997.*

48. In early January 2017, Sue sets up a Clean Dry Unit Trust and transfers the business and all of the assets to the trustee. The trustee issued Sue with an additional new unit as consideration for the transfer of the assets. Both Sue and the trustee elect for the SBRR to apply.

No direct income tax consequences from the transfer of asset

49. Under the SBRR, a transfer of an asset has no direct income tax consequences, except as provided for under Subdivision 328-G.[25A]

50. The effect of the transfer is that Sue no longer holds all the assets in the general small business pool and the trustee of the Clean Dry Unit Trust takes over the depreciating asset pool.

51. If there had been no transfer, Sue could have claimed a deduction of $12,750[26] for the pool for the 2017 income year. The effect of the SBRR and section 328-247 is that, the $12,750 deductible amount is split equally between Sue and the trustee of the Clean Dry Unit Trust.

52. For the 2018 and later income years, Sue cannot deduct any further amount under this general small business pool.[27]

53. For the 2018 income year, the opening pool balance for the trustee of Clean Dry Unit Trust will be $29,750.

Tax values of any membership interests issued for the transfer are set

54. The trustee of the unit trust issues one new unit to Sue as consideration for the transfer.

55. The cost base of these new membership interests is worked out from the sum of the roll-over costs of the transferred assets that are neither depreciating assets nor pre-CGT assets; and the adjustable values of the transferred assets that are depreciating assets; less any liabilities that the transferee assumes, divided by the number of new membership interests.

56. In this case, the sum of the roll-over costs is the adjustable values of the transferred assets that are depreciating assets. The adjustable values are the costs of the depreciating assets less its decline in value up to that time, which is: $36,125 ($60,000 less $17,500 less half of $12,750).

57. The cost base of this one new unit is therefore $36,125.

Example 5 – Direct tax consequence – FX loan

Facts

58. Following from Example 4, prior to the restructure, Sue had taken out a foreign currency denominated loan for $30,000 (Australian dollar equivalent) to finance the business.

59. As part of consideration for the restructure, the trustee of the Clean Dry Unit Trust assumes Sue's foreign currency liability to the bank through a novation.

[25A] See also footnote 9.
[26] 30% of ($60,000 – $17,500) see section 328-190.
[27] Section 328-247.

Other tax consequences are recognised

60. Forex realisation event 4 occurs when Sue ceases to have an obligation, or part of an obligation, to pay foreign currency. In this case, the event happens when the bank discharges Sue from her liability and sets up a new liability with the trustee of the unit trust.

61. Due to the foreign currency movement, the Australian dollar equivalent of Sue's liability to the bank is $25,000. Sue makes a forex realisation gain of $5,000, and this is recognised for income tax purposes.

62. This consequence is recognised because section 328-450 applies to transfers of assets[28] only.

Example 6 – Indirect tax consequence – subsequent debt forgiveness

Facts

63. Dean operates a fishing tour business through a company, where he is the sole director and shareholder. The active assets of the business include a fishing boat, which cost the company $300,000.

64. In January 2017, a discretionary trust is set up, Dean is one of the beneficiaries and a family trust election is made with Dean as the primary individual. The termination value and adjustable value of the boat is $260,000 at this time.

65. The company transfers the boat to the trust for $260,000 as consideration, payable within 60 days. Both the company and the trustee choose to apply the SBRR.

66. The trustee does not pay at that time and enters into a written loan agreement that complies with the requirements of section 109N of the ITAA 1936.

67. In June 2018, the company executes an effective deed to forgive the loan.

Other tax consequences are recognised

68. A transfer of an asset has no direct income tax consequences, except as provided for under Subdivision 328-G. Related rollover relief for depreciating assets is available under section 40-340.

69. The subsequent application of Division 7A to the loan, which was created in connection with the transfer of the assets, is an indirect consequence of the transfer and is not turned off by section 328-450. The forgiveness of the loan or failure to make minimum yearly repayments may give rise to a deemed dividend under Division 7A.

References

Legislative references	ITAA 1936 ITAA 1936 109N ITAA 1936 Pt III Div 7A ITAA 1936 Sch 2F Subdiv 272-D ITAA 1997 ITAA 1997 Div 40 ITAA 1997 40-85 ITAA 1997 40-340

[28] Moreover, it only applies to transfers of certain active assets – see paragraph 328-430(1)(d). This means that even if the foreign currency denominated loan had been a lending (rather than a borrowing) from Sue, the SBRR would not have applied to its transfer.

	ITAA 1997 40-340(1)
	ITAA 1997 40-345(2)
	ITAA 1997 70-90
	ITAA 1997 108-70
	ITAA 1997 Subdiv 115-A
	ITAA 1997 152-115(3)
	ITAA 1997 Subdiv 328-D
	ITAA 1997 328-190
	ITAA 1997 328-210
	ITAA 1997 328-247
	ITAA 1997 Subdiv 328-G
	ITAA 1997 328-430
	ITAA 1997 328-430(1)(d)
	ITAA 1997 328-450
	ITAA 1997 328-450(2)(b)
	ITAA 1997 328-455(1)
	ITAA 1997 328-455(2)(a)
	ITAA 1997 328-455(2)(b)
	ITAA 1997 328-460
	ITAA 1997 328-465
	ITAA 1997 328-465(1)(d)
	ITAA 1997 328-465(1)(d)(i)
	ITAA 1997 328-465(2)
	ITAA 1997 328-470
	IT(TP)A 1997
	IT(TP)A 1997 328-180(6)
	TAA 1953
	Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016
Related Rulings/Determinations	LCG 2016/3

ATO references

BSL: IND