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Addendum

Draft Law Companion Guideline

Small Business Restructure Roll-over: genuine restructure of an ongoing business

This Addendum amends Draft Law Companion Guideline LCG 2016/D3 following consultation.

LCG 2016/D3 is amended as follows:

1. Title

At the end of the title, insert 'and related matters'.

2. Page status (all pages)

At the top of all pages; insert:

Page status: **legally binding**

3. First page header and all footers

Omit 'Draft Law Companion Guideline LCG 2016/D3'; substitute 'Law Companion Guideline LCG 2016/3'

4. Preamble

Omit the preamble; substitute:

Relying on this Guideline

This Guideline 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 the 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

5. Table of Contents

Omit the Table of Contents; substitute:

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6. Paragraph 1

Omit ‘draft’ from the heading.

7. Paragraphs 1 and 2

Omit the paragraphs and substitute

1. This Guideline explains the meaning of the term ‘*genuine restructure of an ongoing business*’ in Subdivision 328-G of the *Income Tax Assessment Act 1997* (ITAA 1997).¹
2. It discusses the features that indicate that a restructure falls within the scope of that term (see Examples 1 to 4 and 8), and those features that indicate that the restructure falls outside (see Examples 5 to 7).
- 2A. The requirements for the small business restructure rollover (SBRR) to apply include a ‘safe harbour’ rule. This is an alternative way to satisfy the ‘*genuine restructure of an ongoing business*’ condition. A small business will be taken to satisfy the condition where, among other things, there is no change in the ultimate economic ownership of any of the significant assets of the business for three years following the roll-over.^{1A} This Guideline illustrates what could constitute a significant asset of a business and explains the impact where there is a change in the ultimate economic ownership within three years (see Example 9).

¹ Unless otherwise indicated, all legislative references in this Guideline are to the *Income Tax Assessment Act 1997*.

^{1A} Section 328-435.

2B. This Guideline also canvasses the interaction with Part IVA (see Example 10) and the availability of the SBRR for transfers of active assets and not ownership interests generally (see Example 11).

2C. The SBRR includes an alternative test to satisfy the ultimate economic ownership requirement. This Guideline illustrates situations where a transaction will not have the effect of changing the ultimate economic ownership of an asset, as a result of the alternative test (see Examples 12 and 13).

8. Paragraph 3

(a) Omit the heading; substitute 'Date of effect'.

(b) Omit the paragraph; substitute:

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 a revenue asset).

9. Paragraph 4

Omit 'small business restructure rollover (SBRR)'; substitute 'SBRR'.

10. Paragraph 6

Omit 'going forward. It'; substitute 'It can encompass a restructure of the way in which business assets are held where that structure is likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business. However, it'.

11. Paragraph 7

Omit:

- continuity of employment of key personnel
- continuity of production, supplies, sales, or services.

Substitute:

- continuity of employment of key personnel, and
- continuity of production, supplies, sales or services.

12. Paragraph 10

(a) At the end of the first bullet point, insert ', or takes place in the course of a winding down to transfer wealth between generations'.

(b) At the end of the fourth bullet point, insert ', and/or'.

13. Paragraphs 12 to 16

Omit the paragraphs and associated heading.

14. Footnote 4

Omit 'to ITAA 1936.'; substitute 'to the *Income Tax Assessment Tax Act 1936* (ITAA 1936).'

15. Paragraph 26

Before the paragraph; insert:

25A. Where Adrian causes the company to issue shares to employees inside a three year period, Adrian cannot access the safe harbour rule in section 328-435. Accordingly, Adrian must consider whether this restructure is a 'genuine restructure of an ongoing business' under the ordinary meaning.

16. Paragraph 33

Omit 'facilitate expansion, innovation and diversification.'; substitute 'raise cash and facilitate growth of the business.'

17. Paragraph 35

Omit 'and innovation'; Substitute 'of the business.'

18. Paragraph 46

Omit second occurrence of 'Silverfox'

19. Paragraph 47-50

Omit all occurrence of 'Silverfox'

20. Paragraph 51

Omit 'Ben Silverfox's'; substitute 'Ben's'.

21. Paragraph 52

- (a) Omit 'Silverfox'.
- (b) Omit 'Ben Silverfox's'; substitute 'Ben's'.

22. Paragraph 54

Omit '*Fish to Gone Fish Inc*'; substitute '*Fish restaurant to Gone Fish Inc.,*'.

23. Paragraph 56

Omit 'safe harbour rule.'; substitute 'safe harbour rule.^{4A}'.

24. Paragraph 57

Omit 'wealth transfer'; substitute 'transfer of wealth'.

^{4A} See section 328-435.

25. Paragraph 59

Omit the paragraph; substitute:

59. The SBRR is *not* available to Holding Co and Gone Fish Inc., as the restructure is undertaken in the course of Nick winding down and facilitating an inter-generational transfer of wealth as opposed to a bona fide restructure of an ongoing business.

26. Paragraph 64

Omit 'dispose those assets'; substitute 'dispose of those assets'.

27. Paragraph 70

Omit the paragraph; substitute:

70. Where the safe harbour rule is met, the application of Part IVA would still need to be considered.⁵

28. Paragraph 73

Omit the paragraph; substitute:

73. The restructure results in a new legal structure that does not replicate the original structure. It changes the way in which assets used in Patricia's ongoing business are held.

29. Paragraph 76

After the paragraph, omit:

Commissioner of Taxation

10 March 2016

Insert:

Genuine restructure – the safe harbour rule

77. The SBRR contains a safe harbour rule.⁶ This rule provides an alternative way to meet the 'genuine restructure of an ongoing business' condition. It is satisfied if there is no change in ultimate economic ownership of any of the significant assets of the business, other than trading stock. Those assets must continue to be active assets of the business.⁷ Ownership interests in the business are not active assets of the business (see Example 11). Further, there must not be significant or material use of those significant assets for private purposes.

78. Where the safe harbour rule is satisfied, it is not necessary to consider whether the arrangement would otherwise be a 'genuine restructure of an ongoing business' under paragraph 328-430(1)(a).

⁵ The safe-harbour only operates to treat the restructure as being genuine for the purposes of paragraph 328-430(1)(a) and does not impact any consideration of the purpose and effect of the restructure for other tax purposes.

⁶ See section 328-435.

⁷ See paragraph 328-430(1)(d).

79. The safe harbour rule does not limit or expand what would otherwise be considered a 'genuine restructure of an ongoing business' within its ordinary meaning.

80. The safe harbour rule only operates to treat the restructure as being genuine for the purposes of paragraph 328-430(1)(a) and does not affect how the purpose and effect of the restructure is considered for other tax purposes.

81. The general anti-avoidance rule in Part IVA of ITAA 1936 (Part IVA) is a provision of last resort and can still apply in appropriate cases to restructures notwithstanding that the safe harbour rule is satisfied (see Example 10).

82. The application of Part IVA to cancel the tax benefit to any particular arrangement depends on a careful weighing of all the relevant facts and surrounding circumstances of each case. Given the wide range of potential circumstances, it is not possible to state definitively when Part IVA will apply to a particular arrangement.

Example 9: significant assets in three year period

Facts

83. Esther is a sole trader and carries on a retail business selling baby products from a bricks-and-mortar shop in an inner city suburb.

84. Esther transfers her business including her shop to a company, where she is the sole director and sole shareholder. The shop is significant in terms of its value relative to the rest of her business assets and its contribution to the business carried on.

85. Twelve months after the transfer, Esther finalises her matrimonial property settlement and transfers the real estate to her former partner. She begins operating her retail business online.

Relevant considerations

86. Whether an asset is significant is a question of fact. In this example, Esther's shop is significant because of its value and because the retail business has been operated from the shop's strategic locations.

Conclusion

87. By transferring the shop to her former partner in under three years from the restructure, Esther cannot rely on the safe harbour rule. Esther instead has to consider whether the restructure was a 'genuine restructure of an ongoing business'.

Example 10: Anti-avoidance rules may have application

Facts

88. Leor operates his small business as a sole trader. Samuel approaches Leor, wishing to acquire his business. One of Samuel's sons is married to Leor's sister.

89. Leor and Samuel enter into an agreement to sell the business.

90. Leor transfers the active assets relating to his business to a newly established discretionary trust where Leor is one of the beneficiaries.

91. To satisfy the ‘genuine restructure of an ongoing business’ condition, the trustee relies on the ‘safe harbour rule’ where no significant assets, apart from trading stock, are disposed of, or used for private purposes, for a three year period.

92. To satisfy the ‘ultimate economic ownership test’, the trustee relies on the ‘alternative ultimate economic test’ where the family trust election is made specifying Leor’s sister is the primary individual.

93. The SBRR is claimed.

94. After the transfer, Samuel starts managing and expanding the business where its service, managements and personnel change materially. The trustee distributes its trust income and capital to Samuel and his family.

Relevant considerations

95. Although all the requirements for the SBRR to apply might be met, the arrangement is contrived and is undertaken as a step in the economic realisation of Leor’s business, as well as wealth transfer to Samuel’s family members.

Conclusion

96. The anti-avoidance rules would need to be carefully considered for their application to the arrangement.

Examples – Requirements other than ‘genuine restructure of an ongoing business’

Example 11: Active assets

Facts

97. Di provides accommodation services for young travellers in an inner-Melbourne suburb. She operates the business through a company, Fair Dinkum Backpackers Co, of which she is the sole director and shareholder.

98. Di decides to reorganise the ownership interest in her business by interposing a non-fixed trust between herself and the company. On 1 August 2016, Di transfers all of her shares to the Trustee of a newly-settled discretionary trust, where she is one of the beneficiaries. The family trust election is made with herself as the primary individual.

99. Fair Dinkum Backpackers Co is a ‘small business entity’⁸ for the 2017 income year. Di is not a small business entity but is connected with Fair Dinkum Backpackers Co.

Relevant considerations

100. Fair Dinkum Backpackers Co is not a party to the transfer. The shares are not active assets of a small business entity.⁹

101. Di and the Trustee are parties to the transfer and connected with Fair Dinkum Backpackers Co. However, the transferred shares are not active assets

⁸ Within the meaning of section 328-110.

⁹ Subparagraph 328-430(1)(d)(i) is not satisfied.

used, or held ready for use, by Fair Dinkum Backpackers Co in the course of carrying on its business, nor are they inherently connected with that business.¹⁰

Conclusion

102. Consequently, the SBRR is not available and Di would need to consider the capital gains tax position from the disposal of her shares.

Example 12: Alternative ultimate economic ownership test

Facts

103. Victoria and Elizabeth are two unrelated individuals operating a business in partnership.

104. Each of Victoria and Elizabeth is a beneficiary of a different discretionary trust. The trustees of these unrelated trusts have been making income and capital distributions to various other beneficiaries for many years.

105. The partners wish to dissolve the partnership and transfer all of the relevant business assets to a newly-incorporated company Newco. The shares in Newco are held by the trustees of the discretionary trusts.

Relevant considerations

106. The SBRR is restricted to circumstances where there has not been a material change in the ultimate economic ownership of assets as a result of the transfer of the assets.

107. A transfer of assets from or to a discretionary trust will not meet the requirements for ultimate economic ownership on their facts. Where it is not possible to demonstrate that ultimate economic ownership of the assets has been maintained, an alternative ultimate economic ownership test is available.¹¹

108. The alternative ultimate economic ownership test provides additional flexibility to small family businesses carried on through non-fixed trusts by allowing them to meet the requirement to maintain proportionate ultimate economic ownership of the transferred assets if the ultimate economic ownership of those assets remains within the family.

109. The alternative test is only available when assets are included in the property of a non-fixed trust that is a family trust¹², that is, a non-fixed trust for which there is a family trust election in force.

110. The transfer of business assets to Newco does not result in the inclusion of assets in the property of either trust. The assets of Newco are not affected by any obligation of either Trustee and these assets are not trust property.

Conclusion

111. The alternative test is not available in respect of the transaction and the SBRR is not available for Victoria and Elizabeth to restructure in this way.

¹⁰ Refer to sub-paragraph 328-430(1)(b)(iii) and requirements in sub-paragraph 328-430(1)(d)(ii). Sub paragraph 328-430(1)(d)(ii) requires section 152-10(1A) to be met in respect of the shares.

¹¹ Paragraph 328-430(1)(c) and section 328-440.

¹² Refer to requirements in paragraph 328-440(a).

Example 13: Alternative ultimate economic ownership test**Facts**

112. Steven operates a business of providing golf instruction and equipment sales through a company structure. Steven and his wife, Vicki are the directors. Steven and Vicki hold 100 ordinary shares in the company. Daniel, their son, holds 100 A class shares while Courtney, their daughter, holds 100 B class shares.

113. Steven and Vicki, in their capacity as directors, may resolve to pay dividends to holders of one class of shares to the exclusion of any other.

114. The company transfers the business' active assets to a trust where he and his family members are beneficiaries. The family trust election is made and Steven is the primary individual specified in the election.

Relevant considerations

115. The SBRR is restricted to circumstances where there has been no material change in the ultimate economic ownership of assets as a result of the transfer of the assets.

116. The transfer of assets to a non-fixed trust means that the proportionate ultimate economic ownership of the assets of the trust has changed materially. However, the alternative ultimate economic ownership test must be considered.¹³

117. To meet this alternative test, 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.

118. In this example, Steven, Vicki, Daniel and Courtney are all members of Steven's family group.

Conclusion

119. The ultimate economic test in paragraph 328-430(1)(c) is satisfied because of the alternative test in section 328-440.

Commissioner of Taxation

13 July 2016

30. Your comments

Omit the heading and paragraph.

31. Legislative references

Omit 'ITAA 1997 Div 86'.

Insert:

ITAA 1936 272 90 of Sch 2F

ITAA 1997 152 10(1A)

¹³ Paragraph 328-430(1)(c) and section 328-440.

ITAA 1997 328 110
ITAA 1997 328 430(1)
ITAA 1997 328 430(1)(b)(iii)
ITAA 1997 328 430(1)(c)
ITAA 1997 328 430(1)(d)
ITAA 1997 328 430(1)(d)(i)
ITAA 1997 328 430(1)(d)(ii)
ITAA 1997 328 440
ITAA 1997 328 440(a)
TAA 1953

32. Related Rulings/Determinations

Omit 'LCG 2016/D2'; substitute 'LCG 2016/2'.

This Addendum applies on and from 13 July 2016.

Commissioner of Taxation
13 July 2016

References

ATO references
BSL: IND

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