TD 2020/6EC - Compendium

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Public advice and guidance compendium – TD 2020/6

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft TD 2019/D1 *Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997?* It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response / action taken
1	The draft Determination represents a change in the ATO view on demergers, as evidenced by various class rulings. Class Ruling CR 2002/81 *Income tax: capital gains: demerger roll-over relief for shareholders: demerger of WMC Ltd*, one of the earliest cases where demerger relief was granted, mimics Example 3 of the draft Determination (demerger to prepare the head entity for sale). But Example 3 concludes that there will be a failure of the nothing else and proportionality conditions, denying demerger relief. Permissive class rulings were also issued in Class Ruling CR 2008/74 *Income tax: demerger of Buru Energy Ltd by ARC Energy Ltd and merger of ARC Energy Ltd with Australian Worldwide Exploration Ltd* and Class Ruling CR 2013/23 *Income tax: demerger of Talon Petroleum Limited by Texon Petroleum Limited*. A more restrictive approach began in 2018 as evidenced by Class Ruling CR 2018/7 *Income tax: Eneabba Gas Limited - return of capital by way of in specie distribution*, Class Ruling CR 2018/31 *Income tax: sale of Westfield Group stapled securities to Unibail-Rodamco SE – capital gains consequences* and the 2018 proposed AMA Group transaction.	While the ATO understands this perception, there was not a more restrictive view adopted in 2018. Rather, the view in the draft Determination is one that has been held for quite a few years. The purpose in issuing this Determination is to provide more transparency, consistency and clarity on the ATO's position in this area. Extrapolating from a selection of class rulings to identify a broader ATO view is problematic. For instance, it is noted that particular information is often withheld or may not be published with certain class rulings. Various other class rulings have been published (Class Ruling CR 2010/4 *Income tax: demerger of Lion Selection Group Ltd by Lion Selection Ltd* and Class Ruling CR 2010/55 *Income tax: demerger of Macquarie Atlas Roads Limited by Intoll Trust (II)*) that are consistent with the draft Determination. The ATO has, however, had consideration to the concerns raised in comments in deciding on an approach to compliance. As noted in the final Determination, the Commissioner will not be devoting resources to a specific compliance project targeting claims for demerger roll-over relief for relevant transactions entered into before the date of the draft Determination. Past transactions may still be looked at in the context of the ATO's usual compliance action (for example, as part of a tax performance program assurance review or because the taxpayer is already subject to compliance action). However, in such cases, when determining what action to take, the

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	It is entirely appropriate for taxpayers to have regard to ATO public documents in a self-assessment system with no requirement to obtain ATO approval for a demerger.	Commissioner will have regard to the reasons why a taxpayer concluded the transaction was eligible for demerger roll-over relief, including gleanings that may have been obtained from past class rulings. This may also be relevant to the remission of any possible interest and penalties. Where the taxpayer requests a private ruling or an amendment to an assessment or where a taxpayer objects to an assessment or where the Commissioner makes submissions in litigation, the Commissioner will act consistently with the views in the final Determination.
2	There has been a substantial time between the enactment of the demerger rules in 2002 and the ATO publicly setting out its considered view on this fundamental aspect of demerger relief in March 2019.	Agreed. The purpose of this Determination is to provide more transparency, consistency and clarity on the ATO's position in this area.
3	The final Determination should not apply retrospectively. Paragraph 41 of the draft Determination states 'When the final Determination is issued, it is proposed to apply both **before** and after its date of issue.' (emphasis added). The view in the draft Determination should only apply prospectively from its date of release (20 March 2019). Given class rulings issued by the ATO since 2002 contributed to taxpayers' perception that multi-step transactions are acceptable, Law Administration Practice Statement PS LA 2011/27 *Determining whether the ATO's views of the law should be applied prospectively only* obliges the ATO to only apply the draft Determination to future transactions. In the alternative, the Commissioner could state in the final Determination that compliance resources will not be devoted to demergers undertaken before the date of the Determination (for example, as was done in Practical Compliance Guideline PCG 2018/9 *Central management and control test of residency: identifying where a company's central management and control is located* on the CMC residency test following Taxation Ruling TR 2018/5 *Income tax: central management and control test of residency*, or Taxation Determination TD 2017/24 *Income tax: where an amount included in a beneficiary's assessable income*	The factors in PS LA 2011/27 have been considered. We would not agree with a contention that the ATO has generally adopted a more permissive view of demerger relief prior to the issue of the draft Determination – as outlined in Issue 1 of this Compendium. We would also note that the views in this Determination have been previously communicated to advisors and taxpayers in the context of particular transactions, although it is acknowledged that these views have not been universally known or understood. Following consideration of concerns raised in submissions and the above matters, we have decided to adopt the compliance approach discussed in Issue 1 of this Compendium.

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	under subsection 99B(1) of the Income Tax Assessment Act 1936 (ITAA 1936) had its origins in a capital gain from non-taxable Australian property of a foreign trust, can the beneficiary offset capital losses or a carry-forward net capital loss ('capital loss offset') or access the CGT discount in relation to the amount?).	
4	The draft Determination is inconsistent with Law Administration Practice Statement PS LA 2005/21 *Application of section 45B of the Income Tax Assessment Act 1936 to demergers*. Paragraph 76 of PS LA 2005/21 (considering paragraph 45B(8)(i) of the *Income Tax Assessment Act 1936* (ITAA 1936), which only applies to a 'demerger' as defined in subsection 125-70(1)) of the *Income Tax Assessment Act 1997*[1] states (emphasis added): … **A prearranged disposal of the head entity or demerged entity shares** could have as its only substantial object increased business performance. **There may be circumstances where the business performance of one or both of the head entity or demerged entity is enhanced by merging one of those entities with another like business structure. Such a merger could for example involve the disposal of the head entity or demerged entity under a scrip for scrip transaction.** Alternatively, it may be that the efficiency of a business is enhanced by the introduction of a new group of owners, such as under a management buy-out.	Paragraph 76 of PS LA 2005/21 should be read in context. PS LA 2005/21 is dealing with the application of section 45B of the ITAA 1936 and not the application of section 125-70. Revised public guidance on section 45B of the ITAA 1936 is being considered, which may involve an update to PS LA 2005/21. This perception of inconsistency will be considered in any update to the Practice Statement.
5	The draft Determination is departing from the ordinary meaning of 'restructuring'. Including subsequent sales or capital raisings does not reflect the ordinary meaning of 'restructuring'.	We consider that a change to a company's or trust's ownership structure is part of and within the ordinary meaning of a 'restructuring' and is a fair and reasonable construction of the word which gives effect to the legislative purpose of Division 125. This is explained in more detail at paragraphs 56 to 58 of the final Determination.
6	The draft Determination is inconsistent with the Revised Explanatory Memorandum to the New Business Tax System	Identifying the scope of the 'restructuring' is the factual prerequisite to applying the conditions of subsection 125-70(1). The ATO considers the view in the draft

[1] All legislative references in this Compendium are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

	(Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002 (the EM). The EM makes it clear that the proportionality condition must be applied to owners of interests in the head entity, not by reference to other transactions not involving those owners.	Determination is consistent with the EM and broader policy context. We have made changes to the draft Determination to ensure a better focus on identifying what transactions form part of the restructuring.
7	A principle of statutory interpretation is that a liberal approach should be taken to construing a concession or exemption. Four cases (two from the High Court, one each from the Federal Court and a State Supreme Court) emphasise the need for a liberal approach.	Recent High Court authority is clear that statutory construction is about the meaning of the statutory text, in its context (*Commissioner of Taxation v Consolidated Media Holdings Ltd* [2012] HCA 55 at [39]). The Explanation section of the final Determination sets out in some detail the reasons why, having regard to the text and context, that the interpretation in the final Determination is preferred.
8	Paragraph 4 of the draft Determination is confusing and contradictory. Paragraph 4 suggests that the 'restructuring' may have a narrower scope than other parts of the draft Determination. It fails to provide a clear practical delineation of what is in and out, to help practitioners. A 'restructuring' should be limited to transactions involving the interest owners, not other entities in associated transactions. A reader is left with the impression that the ATO will form a view about a transaction (based on some underlying policy view held by the ATO which the draft Determination does not explain) and will then justify the conclusion by including steps under paragraph 2 of the draft Determination or excluding steps under paragraph 4.	We have made changes to paragraph 4 of the final Determination to more clearly articulate what transactions may not necessarily form part of the 'restructuring'.
9	What is the integrity concern behind the draft Determination and the mischief that this interpretation is seeking to guard against? There is no explanation why the transactions are abusive or inimical to the objects of the regime. One outcome of the draft Determination is that transactions that would ultimately trigger capital gains tax (CGT) consequences (and tax being paid) will no longer be undertaken. Why would the ATO want to prevent a corporate group being divided so that parts can be sold? Some tax will be collected from the subsequent sale and the demerger sale facility. If the	The integrity concern is that demerger relief is being claimed for transactions that should not qualify because they change the economic position of owners by involving more than the separation of a subsidiary. CGT consequences should be triggered for such a transaction. Paragraph 6 of the final Determination articulates this concern, as well as various parts of the Explanation (for example, paragraphs 46, 49, 56, 64).

	first step is not a 'demerger', the transaction will likely not proceed and no tax will be collected.	
10	It may be appropriate to engage in a discussion as to whether some form of safe harbour can be developed for taxpayers who are inadvertently captured by the expanded meaning of 'restructuring'. Safe harbours would ensure that there is no impediment to entities restructuring their operations. For example, a safe harbour could clarify that a transaction that occurs 3 months prior to the proposed separation of a demerger subsidiary will not be deemed to be part of the 'restructuring'.	The ATO is considering this proposal in the context of a broader review of public guidance on Division 125.
11	The draft Determination will cause considerable problems for potential demerger transactions. Rights issues, capital raising and sale facilities (and other associated transactions under which the interest owners do not acquire something else under a planned transaction) are regularly implemented in conjunction with a demerger for genuine business reasons. There is no mischief in such transactions, yet the draft Determination would cause them to be denied demerger relief. The draft Determination is a significant change in administrative practice. Any change should instead be dealt with by legislative amendment. The Commissioner should apply Part IVA of the ITAA 1936 in appropriate circumstances, rather than creating difficulties for genuine demerger transactions without any mischief.	The policy concerns are noted. As discussed under Issues 1 and 3 of this Compendium, the position in the final Determination accords with the existing ATO approach.
12	The draft Determination is inconsistent with the Review of Business Taxation, 1999, *A Tax System Redesigned* (Ralph report). The Ralph report did not make demerger relief conditional on a requirement that no other events (such as a capital raising or share sale) occur in conjunction with the demerger. Chapter 19 of the Ralph report is labelled 'Capital Market Incentives' – its entire focus was directed at solving the problem that 'the current CGT arrangements are an impediment to corporate acquisition activity in Australia.'	We consider it is implicit from the Ralph report that other events in conjunction with a demerger could prevent demerger relief being available. The Ralph report emphasised that an important condition for provided CGT relief for a reorganisation involving a demerger was 'leaving members in the same economic position as they were immediately before the reorganisation'. In those circumstances where there is no change other than the triggering of a CGT liability, and therefore the CGT could be an impediment to implementing the reorganisation. The quoted reference to corporate acquisition activity is directed to scrip for scrip roll-over relief which was recommended in the same Chapter of the Ralph report.

13	The view in the draft Determination means fewer transactions will qualify as a 'demerger', preventing the application of the integrity rules in Subdivision 125-B of the ITAA 1936. If there is a 'demerger', the cost base apportionment rules in sections 125-85 and 125-90 apply automatically, even if a taxpayer does not choose roll-over or there is no CGT event. If there is no 'demerger' because of the view in the draft Determination, taxpayers will be able to set the cost base of any shares received under a separation as they think best, regardless of the basic principle in section 125-80 that the first element of the cost base of the two shares should be no higher than the cost base of the original share. There is nothing in section 6BA of the ITAA 1936, the direct value shift rules or the indirect value shift rules that would achieve the same outcome as under section 125-80.	We agree that a separation that is not a 'demerger' will not be bound by the cost base apportionment principle in section 125-80. However, the cost base of shares received under such a separation (which in legal form is usually an in specie distribution of capital or a dividend or some combination of each) is an ordinary corporate transaction and is subject to the cost base rules in Divisions 110 and 112.
14	The draft Determination places excessive emphasis on the word 'restructuring'. The word 'restructuring' is largely devoid of meaning. It was chosen because it was amorphous and meant nothing. As long as the transaction results in 80% of the ownership being shifted (whether by transfer, cancellation or issue of shares), a transaction will be a 'demerger'. The two words are synonyms – every demerger involves a restructuring, and every restructuring amounts to a demerger. The draft Determination reads into 'restructuring' very ambitious meanings so that it serves as the means of prohibiting particular transactions.	It is evident from the EM that the legislation was designed to allow flexibility regarding the precise means by which ownership interests in a demerger subsidiary were delivered to the owners of original interests in the head entity of the demerger group. As such the word is deliberately undefined for tax purposes so that it takes its ordinary meaning having regard to the context and purpose of Division 125. We do not consider, however, that it is devoid of meaning. It is used 3 times in the early paragraphs of subsection 125-70(1): first there must be 'a restructuring of the demerger group', and then 'under the restructuring' two conditions are applied. Principles of statutory interpretation suggest that we should strive to give meaning to every word in a statute (*Project Blue Sky Inc v Australian Broadcasting Authority* [1998] HCA 28).