

TA 2019/1 - Multiple entry consolidated (MEC) groups avoiding CGT through intra-group debt

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Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more information about Alerts. See [Alerts](#) issued to date.

Description

We are reviewing specific variations of known arrangements where a multiple entry consolidated (**MEC**) group sells a CGT asset (**Relevant Asset**) with a large unrealised capital gain by way of moving the Relevant Asset into an 'eligible tier-1 company'¹ (**ET-1 Company**) with significant (existing or newly created) intra-group debt and then selling the shares in the ET-1 Company to a third party purchaser (**Purchaser**). The debt usually approximates the value of the assets of the company. As part of the arrangement, the Purchaser undertakes to ensure the ET-1 Company's intra-group debt is extinguished on completion of the sale.

The arrangements are, in substance, a sale of the Relevant Asset by the MEC group to the Purchaser with the agreed purchase price being the sum of the purchase price for the shares in the ET-1 Company and the amount of the intra-group debt that is repaid.

By entering into these arrangements rather than selling the Relevant Asset directly to the Purchaser, the MEC group receives the same total 'consideration' for the Relevant Asset but purportedly avoids tax on the large capital gain that would otherwise have arisen with an asset sale.

The arrangements usually display most or all of the following features:

- The MEC group (or a member of said group) has agreed to dispose of the Relevant Asset to a Purchaser.
- An internal restructure is undertaken within the MEC group, including the transfer of the Relevant Asset to a new or existing ET-1 Company and the transfer of any other assets out of that ET-1 Company. Alternatively, the ET-1 Company may acquire the Relevant Asset indirectly by acquiring a member of the MEC group that owns the asset. There are no tax consequences for these transactions due to the operation of the single entity rule.
- The ET-1 Company has existing intra-group debt or may incur intra-group debt as part of the internal restructure. The effect of the intra-group debt is

¹ See the meaning in section 719-15 of the *Income Tax Assessment Act 1997* (ITAA 1997). All legislative references are to the ITAA 1997 unless otherwise indicated.

to significantly reduce the market value of the shares in the ET-1 Company and, consequently, on the disposal of those shares reduce any capital gain to a nominal amount.

- The foreign resident shareholders of the ET-1 Company enter into an agreement with the Purchaser for the sale of the shares in the ET-1 Company. Under the agreement, the purchase price for the shares in the ET-1 Company reflects the intra-group debt in the company. Further, the Purchaser undertakes to ensure that the ET-1 Company repays the outstanding intra-group debt on, or shortly after, the completion of the sale.
- On completion of the sale of the shares in the ET-1 Company, the Purchaser pays the purchase price for the shares and arranges for the outstanding intra-group debt to be repaid. This may be done under relevant arrangements by way of the Purchaser paying the creditor in the MEC group directly and the ET-1 Company recording the Purchaser as having subscribed for additional equity in the ET-1 Company.
- The sale of the shares in the ET-1 Company results in the ET-1 Company leaving the MEC group.
- The foreign resident shareholders of the ET-1 Company may have no capital gain or, if the capital gain is not disregarded under Division 855, a relatively small capital gain on the sale of the shares in the ET-1 Company due to the effect the intra-group debt has on the value of the ET-1 Company. In addition, CGT event L5 does not apply to the ET-1 Company. This is because ET-1 Companies are subject to the modified tax cost setting ('pooling') rules in Subdivisions 719-J and 719-K, rather than the tax cost setting amount rules for entities that cease to be a subsidiary member of a consolidated group in Division 711.
- The foreign resident shareholders of the ET-1 Company, together with its related entities, receive from the Purchaser a total sum representing the value of the Relevant Asset but in the form of sale proceeds from the sale of the shares in the ET-1 Company and the intra-group debt repayment.
- Following completion of the sale of the shares in the ET-1 Company, the Purchaser may move the Relevant Asset out of the ET-1 Company into a controlled entity of its choosing.

The diagram below illustrates a simplified example of the arrangement.



*In this example, the shares are taxable Australian property and therefore the capital gain is not disregarded under Division 855. If the Relevant Asset was sold directly by the Provisional Head Co to the Purchaser, the Provisional Head Co would have made a capital gain of \$105m (that is, capital proceeds of \$120m less cost base of \$15m).

What are our concerns?

We are concerned that taxpayers may be entering into these arrangements to avoid realising large capital gains on the disposal of CGT assets.

More specifically, aspects of the arrangements that concern us include:

- The intra-group transactions leading up to the sale of the shares in the ET-1 Company have no apparent commercial rationale and appear designed to put the MEC group into a position to exploit the special rules that apply when disposing of membership interests in an ET-1 Company.
- The parties have entered into this arrangement in circumstances where a direct sale of the Relevant Asset to the Purchaser would have been simple, viable and commercially expected.
- The arrangement is in substance a sale of the Relevant Asset but the parties (or the vendor unilaterally) have structured it in the form of a share sale with the purchaser repaying the intra-group debt on completion.
- Commercially, the 'agreed consideration' for the Relevant Asset is the sum of the sale price for the shares in the ET-1 Company and the intra-group debt repayment.
- The MEC group, together with its related entities, receives (and the Purchaser pays) the same total sum under the arrangement as would have been the case if the Relevant Asset had been sold directly to the Purchaser.

The arrangements appear designed to significantly reduce or eliminate any CGT that might otherwise have been payable by the MEC group (or its related entities) in respect of the sale of the Relevant Asset to the Purchaser.

We consider that Part IVA of the *Income Tax Assessment Act 1936* may apply to these arrangements.

What are we doing?

We are actively reviewing these arrangements. Taxpayers and advisers who enter into these types of arrangements will be subject to increased scrutiny.

What should you do?

If you have entered, or are contemplating entering, into an arrangement of this type we recommend:

- you seek independent professional advice, and
- review your arrangements.

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References

ATOlaw topic(s)	Income tax ~ Capital gains tax ~ CGT events ~ CGT events L1 to L8 – consolidated groups and multiple entry consolidated groups
Legislative references	ITAA 1936 ITAA 1936 Part IVA ITAA 1997 ITAA 1997 104-520 ITAA 1997 Div 711 ITAA 1997 719-15 ITAA 1997 Subdiv 719-J ITAA 1997 Subdiv 719-K ITAA 1997 Div 855
Related practice statements	PS LA 2008/15
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