

1994

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

---

TAXATION LAWS AMENDMENT BILL (NO. 2) 1994

---

SUPPLEMENTARY EXPLANATORY MEMORANDUM

(Circulated by the authority of the Treasurer the Hon Ralph Willis, M.P.)



## **General Outline and Financial Impact**

### **Amendments to exclude accruals assessability of certain securities**

Amends Division 16E of Part III to remove an unintended consequence in relation to certain securities issued in a series. The amendment ensures that later issues in a series of securities will not fall within the scope of the Division where securities in the first of that series are outside its scope.

***Date of effect:*** Applies to qualifying securities issued after 16 December 1984.

***Proposal announced:*** The Treasurer's Press Release No. 36 of 24 March 1994.

***Financial impact:*** It is not expected that this amendment will have any impact on revenue.

### **Capital gains tax amendments**

Amends the Bill to:

- replace the proposed share value shifting provisions with new provisions which simplify anti-avoidance measures and which clarify the application of capital gains tax to value shifts;
- ensure the proposed rebatable dividend adjustment provisions operate appropriately, by making technical amendments;
- re-number the new subsections relating to rebatable dividends out of pre-acquisition profits; and
- extend the types of subvention payments which are taken into account for the purposes of the proposed group company capital loss transfer provisions to ensure the provisions operate as intended.

***Financial impact:*** None.

**Development allowance and general investment allowance**

Amends the Bill to correct a typographical error in clause 89.

***Financial impact:*** None.

## *Amendment 1*

# ***1***

## ***Amendments to exclude the accruals assessability of certain securities***

### **Summary of proposed amendments**

#### **Purpose of amendments**

1.1 To remove an unintended consequence of Division 16E in relation to certain securities issued in a series. Broadly, where the first security issued in a series is not a qualifying security (ie, Division 16E does not apply) and a subsequent security issued in that series would otherwise be a qualifying security (eg, because it is issued at a discount), the amendments will treat that subsequent security as not being a qualifying security within the scope of Division 16E. This object is expressed in *Clause 21A*.

#### **Date of effect**

1.2 The amendments apply to qualifying securities issued after 16 December 1984 [*Clause 21C*].

### **Background to the amendment**

1.3 Division 16E of Part III of the Assessment Act applies to a class of securities defined as "qualifying securities". These securities are divided into two broad categories for the purposes of Division 16E: fixed return securities and variable return securities. Fixed return securities are securities under which all of the cash flows are known at the outset. Examples are bills of exchange and fixed interest term deposits. Variable return securities are qualifying securities that are not fixed return securities.

1.4 Paragraph (e) of the definition of 'qualifying security' imposes an additional qualifying test in relation to fixed return securities. In simple terms, fixed return securities only fall within Division 16E where they are issued at a discount greater than 1.5% per annum. Whether or not a security is a qualifying security is determined at the time of issue of the security.

1.5 It is not uncommon for securities to be issued with exactly the same terms and conditions at different, usually frequent and regular, points in time. This is referred to as issuing securities in a 'series'. There are several reasons for issuing securities in a series, although primarily it is to increase the liquidity of the market for the security and to avoid the additional administration costs of establishing a new 'series'.

1.6 Should the required market interest rate rise in the future, it is possible that subsequent issues in a 'series' of securities would come within the scope of Division 16E even though previous issues in that series were outside it. The reason is that, under those conditions, it would be necessary to issue new securities in the series at a discount. Division 16E may then apply.

1.7 In these circumstances, for the purpose of ascertaining the right tax liability it would be necessary to be able to separately identify those securities in the series to which Division 16E applies and those to which it did not apply. However in a practical sense this is not possible because securities issued in a series are fungible and ordinarily not capable of separate identification. The only practical outcome would be to discontinue the series and create a separate series in order to identify securities according to different tax effects.

1.8 This outcome is undesirable as it is likely to have significant adverse implications for the efficient operation of Australia's capital markets. These amendments will prevent such a consequence.

## **Explanation of amendments**

### **Definition of qualifying security amended**

1.9 Division 16E is amended by this Bill to ensure that later issues in a series of securities will not fall within the scope of the Division where securities in the first issue of that series are outside its scope.

1.10 The definition of 'qualifying security' in subsection 159GP(1) is amended by the insertion of a new paragraph, (ba). It specifies that a security is not a qualifying security if it is **'part of an exempt series'** [*Clause 21B(a)*].

### **Exempt series of securities**

1.11 The circumstances in which a security is part of an exempt series are set out in *new subsection 159GP(9A)*.

1.12 In order for a security to be regarded as issued as part of an exempt series the first security issued in the series after the commencement date of Division 16E (ie, 16 December 1984) must not be a 'qualifying

security', as defined in subsection 159GP(1) [*Clause 21B(b); new subsection 159GP(9A)*].

1.13 To be treated as issued in the same series, securities must have exactly the same payment dates, payment amounts and be the same in respect of all other terms [*Clause 21B(b); new paragraphs 159GP(9A)(b),(c)*]. In short, securities issued in a series must have precisely the same terms and conditions. They should, for example, have the same rate of interest, and the same payment and maturity date irrespective of issue date. However the fact that, in a given case, securities could be separately identified, eg by serial number, would not preclude their being treated as issued in a series.

1.14 Nor will the fact that a security has a different issue price from another security have a bearing on whether they were both issued in the same series [*Clause 21B(c); new subsection 159GP(9B)*].

1.15 Specifically, the amendments provide that where:

- the first security issued in a series after 16 December 1984 is not a qualifying security; and
- at a later time, the same issuer issues another security in that series, ie with the same payment dates, payment amounts and other terms as the first in the series

the later security is part of an exempt series [*Clause 21B(b); new paragraphs 159GP(9A)(a),(c)*].

1.16 That is, later securities will not be treated as qualifying securities under these rules if the very first securities issued in the series were not qualifying securities.

## *Amendments 2 to 22*

# **2** *Capital gains tax amendments*

### **Overview**

2.1 The amendments will make changes to the capital gains tax (CGT) provisions of the Bill. These are explained below.

2.2 The references below to amendment numbers correspond to the numbers in brackets in the margin of the amending legislation.

### **(1) Share value shifting arrangements**

#### **Background to the amendment**

2.3 Subdivision A of Division 3 of Part III of the Bill addresses the application of CGT to share value shifting arrangements by inserting a new Division 19B of Part IIIA of the Act.

2.4 The Government proposes to amend this Subdivision of the Bill by inserting a replacement Division 19B. [*Amendment 2*]

#### ***Why are changes being made?***

2.5 The originally proposed Division 19B operated on the basis of identifying a single share out of which value was shifted and a single share into which value was shifted. Although this basis could be used for shifts of value involving multiple shares, representations were made that the provisions ought to be more clear in their application to value shifts where a proportion of the shift is not subject to the Division (for instance, because the shift in value is partly to shares held by a non-associated person).

2.6 Also, representations were made that the provision in Division 19B which prevented a taxpayer taking undue advantage of the Division to avoid CGT when the value shifted was within the taxpayer's own shares was administratively difficult to apply. The provision would have required taxpayers to ascertain, over a period of four years or more, the

order in which the disposal of shares involved in the value shift took place ('the four year rule'). The Government has decided on a simpler method of achieving the same anti-avoidance effect.

### Explanation of amendments

2.7 The replacement Division 19B ensures that the share value shifting provisions operate only to the extent that the shift in value is subject to the Division (i.e. to the extent that the shift is from shares held by the controller of a company or an associate into shares held by that person or an associate of that person). This is achieved by adopting a proportionate basis rather than the current 'share by share' basis. Under the proportionate basis the increase in value of shares into which value is shifted is made referable to the decrease in value of particular shares out of which value is shifted, and *vice versa*.

2.8 The replacement Division 19B also adopts an administratively simpler approach to achieve the anti-avoidance function of the four year rule. Under this simpler approach, when the shift in value is within the taxpayer's own shares the cost base of the shares out of which value is shifted is reduced by the amount of the cost base attributable to the shifted value, and the increase in the cost base of shares into which value is shifted is, generally speaking, limited to the same amount. As originally proposed, Division 19B reduced the cost base of the decreased value share by the value shifted, and, in most cases, made an equivalent increase in the cost base of the increased value share.

2.9 The replacement of Division 19B requires a minor addition to the information about share value shifting transactions which the taxpayer is required to retain to enable determination of the CGT consequences. The information the taxpayer is required to retain is currently listed in the amendment proposed by the Bill to the record-keeping requirements in section 160ZZU of the Act. The adoption of the proportionate approach means that calculation of the increase in value of shares which are held by non-associates is now also required by taxpayers. Accordingly, this information is to be added to the list contained in the proposed amendment to section 160ZZU [*Amendment 3*].

2.10 For convenience, the whole of the chapter of the original explanatory memorandum concerning value shifting has been rewritten. This revised chapter, **which is contained in the appendix to this supplementary explanatory memorandum**, explains the operation of the replacement Division 19B in detail.



## (2) Payment of rebatable dividends from certain share premium accounts and revaluation reserves

### Background to the amendment

2.11 Clause 61 of the Bill inserts new section 159GZZZMA to remove the CGT advantages of dividend rebate arrangements in relation to share buy-backs.

#### *Why are changes being made?*

2.12 The purpose of the amendments to clause 61 is to ensure that, on the disposal of shares in an off-market share buy-back, the provisions of the Bill will not result in the amount that is taken as the consideration for CGT purposes exceeding the buy-back price.

2.13 Technical amendments are also being made to other clauses relating to rebatable dividends.

### Explanation of amendments

2.14 The amendments will have the effect that the amounts of the purchase price of the share that are:

- treated as paid out of a share premium account created under an arrangement (new subsection 159GZZZMA(2)), or
- treated as paid out of a revaluation profit (new subsection 159GZZZMA(5))

cannot exceed that part of the purchase price that is treated as a dividend.

2.15 This is achieved by specifying that those amounts cannot exceed 'the dividend amount' (as defined) *[Amendments 7 to 9]*.

2.16 Also, to ensure that the amounts treated as paid out of a share premium account cannot exceed that part of the purchase price that is treated as a dividend, it is necessary to take into account amounts which have actually been credited against the share premium account. The amendments effect this by changing the formula in new subsection 159GZZZMA(2). *[Amendment 7]*

2.17 The ordering arrangement in new subsection 159GZZZMA(6) is also to be changed to refer to the dividend amount *[Amendment 10]*.

2.18 The amendments to clause 61 also correct the reference in new paragraph 159GZZZMA(1)(c) to 'subsection 159GZZZP(1A)'. This reference is being changed to 'subsection 159GZZZP(3)'. *[Amendment 6]*

2.19 Clauses 65 and 67 of the Bill deal with certain adjustments to:

- the reduced cost base of shares (section 160ZK of the Act);
- amounts treated as return of capital on shares (section 160ZL); or

- amounts treated as reductions from capital gains (section 160ZA).

These adjustments are referred to as rebatable dividend adjustments. They relate to inter-corporate dividends that qualify for the dividend rebate.

2.20 An inter-corporate dividend may, depending on the circumstances, qualify for a full or partial rebate of tax or may not be rebatable. When a partial dividend rebate is allowable, it is necessary for the purposes of the adjustments to determine the proportion of the dividend that is rebatable.

2.21 The amendments correct the formulae provided in the Bill to determine this proportion. The effect of the amendments is to clarify that the proportion is to be calculated by comparing the amount of the dividend rebate in fact allowed on the dividend with the company tax payable on the dividend at the normal company tax rate [*Amendments 17 to 22*].

### **(3) Rebatable dividends out of pre-acquisition profits**

#### **Background to the amendment**

2.22 Clause 65 of the Bill amends section 160ZK of the Act to remove the CGT advantages of dividend rebate arrangements in relation to distributions of pre-acquisition profits.

#### *Why are changes being made?*

2.23 Paragraphs (a) to (d) of clause 65 propose to introduce new subsections 160ZK (1A) and (3A).

2.24 However, the *Taxation Laws Amendment Act 1994* inserts other subsections 160ZK(1A) and (3A). Therefore it is necessary to re-number these provisions in the Bill.

#### **Explanation of amendments**

2.25 The amendments replace the references to subsections 160ZK (1A) and (3A) with subsections 160ZK (1B) and (3B) respectively. [*Amendments 11 to 16*]

### **(4) Group company capital loss transfers**

#### **Background to the amendment**

2.26 Clause 55 of the Bill allows an increase in the cost base of shares in or loans to a company which increase in market value because of a capital loss transferred to it from a company in the same company group.

2.27 Clause 55 also allows the amount of any subvention payment (i.e. the amount paid as consideration for the transfer of the loss) to be taken into account when making appropriate cost base adjustments.

***Why are changes being made?***

2.28 As currently drafted, clause 55 unintentionally restricts the subvention payments which can be taken into account to those made by a subsidiary to a parent company (i.e. payments under subsection 160ZP(11) of the Act). Subvention payments between sister companies should also be taken into account.

**Explanation of amendments**

2.29 The amendments replace the references in clause 55 to subsection 160ZP(11) with references to subsection 160ZP(12). This ensures that subvention payments made both by a subsidiary to a parent and between sister companies can be taken into account for cost base adjustment purposes. ***[Amendments 4 and 5]***

*Amendment 23*

**3**

***Development allowance and  
general investment allowance***

This amendment is to correct a typographical error in clause 89 of the Bill. The amendment is correctly referred to in the original Explanatory Memorandum.



## APPENDIX : REVISED CHAPTER ON SHARE VALUE SHIFTING ARRANGEMENTS

Chapter

**5**

### **Capital Gains Tax - Share value shifting arrangements**

*Subdivision A of Division 3 (Part 3) of the Bill*

#### **Overview**

5.1 This Bill will subject share value shifting arrangements to appropriate capital gains tax (CGT) treatment.

#### **Summary of proposed amendments**

##### **Purpose of amendments**

5.2 To remove the CGT advantages of share value shifting arrangements *[Clause 22]*.

##### **Date of effect**

5.3 The amendment is to apply to arrangements where the share value shift occurs after 12:00 midday Eastern Summer Time on 12 January 1994 *[Clause 25]*.

#### **Background to the legislation**

##### **What is share value shifting?**

5.4 Share value shifting is the shifting of value from one share or class of shares in a company into another share or class of shares. There are many ways in which value may be shifted from one share in a company to another. Examples are changes to dividend or voting rights in the company, and a general dilution of value of existing shares when the company issues new shares for less than market value.

5.5 In some cases of share value shifting the effect of a disposal of a share or shares to another person may be achieved without an actual disposal for CGT purposes. In addition share value shifting may be undertaken as an attempt to generate a capital loss or to diminish a capital gain which would otherwise have accrued on the disposal of shares. For instance, a person may arrange for value to be shifted from one class of shares to another class also owned by the person, and then dispose of the shares out of which value has been shifted.

**What were the CGT consequences of share value shifting before these proposed amendments?**

5.6 Broadly speaking, the CGT provisions of the Act apply where there is a disposal of an asset. Even though a share value shift may achieve the *effect* of a disposal of a share or part of a share, it would usually not have been a disposal for CGT purposes before these proposed amendments.

5.7 However, some share value shifting transactions would entail CGT consequences even without these proposed amendments. A share value shift will generally come about because an act or transaction has taken place in relation to a share, or because an event affecting the share has occurred. In such a case subsection 160M(7) of the Act would apply to any consideration received by reason of the act, transaction or event. Moreover the general anti-avoidance provisions of Part IVA of the Act may apply in relation to a tax benefit gained from a share value shift.

5.8 One type of transaction relating to shares which may involve a value shift is the issue of bonus shares. The value shifting aspect of such issues are addressed by specific provisions in Part IIIA of the Act, namely Divisions 8 and 8A.

**What are the CGT consequences of share value shifting under the proposed amendments?**

5.9 Both subsection 160M(7) and Part IVA of the Act may continue to apply to share value shifting. However, the proposed amendment introduces new Division 19B into Part IIIA which specifically applies to certain share value shifting arrangements. Where this new Division applies, subsection 160M(7) will not operate; however, the operation of Part IVA is not excluded. To the extent that a share value shift is addressed by the specific provisions of Part IIIA relating to the issue of bonus shares, those provisions will continue to apply to the exclusion of new Division 19B.

5.10 New Division 19B does not extend to all situations of share value shifting. For the Division to apply, the following elements (which are explained in detail later in this chapter) are required:

- a controller of a company; and
- an arrangement under which something is done in relation to a share or shares in the company which it is reasonable to conclude caused:
  - a material decrease in value of one or more post-CGT shares (i.e. acquired on or after 20 September 1985) held by the controller or an associate of the controller; and
  - an increase in value (or issue at less than market value) of another share or other shares held by that person, or an associate of that person.

5.11 Where these elements are present there is:

- a capital gain to the extent that:
  - the shares which increase in value are pre-CGT shares (i.e. acquired by the shareholder before 20 September 1985) or are held by someone else; and
  - the amount of the decrease in value of the decreased value shares which relates to that increase exceeds the cost base or indexed cost base attributable to that decrease; and
- in all cases, appropriate cost base adjustments to the shares involved in the value shift having regard to the capital gain and to ensure that there are no CGT advantages to be gained from the shift.

## Explanation of amendments

5.12 The object of the Bill and of new Division 19B is to remove the CGT advantages of share value shifting arrangements [*Clause 22 and new section 160ZZRJ*].

5.13 This is to be achieved by inserting new Division 19B into Part IIIA of the Act [*Clause 23*].

5.14 To assist understanding of the provisions contained in new Division 19B, a simplified outline and list of definitions is provided by the Bill [*New section 160ZZRJ and new section 160ZZRK*].

### (a) Requirements for Division to apply

5.15 The share value shifting provisions will apply if:



- a share value shift takes place under an arrangement involving a company and a taxpayer;
- the taxpayer is a controller of the company at some time during the course of the arrangement; and
- there is a material decrease in the market value of a share involved in the share value shift.

*[New section 160ZZRL].*

5.16 The elements of these three prerequisites are discussed below.

*(i) Arrangement*

5.17 An arrangement is very broadly defined. It incorporates the elements contained in the definition of scheme in subsection 177A(1) of the Act, as well as the concept in subsections 177A (3) and (4) that the arrangement may be that of one person or more than one person *[New subsection 160ZZRM(3)]*.

5.18 There does not need to be a tax avoidance purpose before the share value shifting provisions may apply.

5.19 The concept of an arrangement allows a link to be made in a series of particular events to bring them all within the one arrangement. This ensures that even if, for instance, a share value shift proceeds over a long period, each decrease in value of a share may be attributed to a single arrangement.

5.20 Under the arrangement something must be done ‘in relation to’ (which also includes ‘to’) a share or shares in the company. This proviso is intended to require a direct connection between the thing done and the shares in the company. Therefore a purely incidental share value shift as a result of, for instance, particular investments undertaken by the company will not trigger the share value shifting provisions. *[New paragraph 160ZZRM(1)(a)]*.

5.21 The examples provided in *new paragraph 160ZZRM(1)(a)* of changing voting rights, buying back shares and issuing new shares at a discount are examples of where something is done in relation to a share or shares of the company. However, the list of examples is not intended to limit the types of situations where something is done in relation to a share or shares in the company for the purposes of the share value shifting provisions.

5.22 The thing done under the arrangement may be done by the company itself (for instance, by a company resolution or by an agent of the company or a company liquidator), by the controller or by an associate

of the controller. It may be done by those persons acting alone or with one or more persons. *[New paragraph 160ZZRM(1)(a)].*

***(ii) Share value shift: decreased value share***

5.23 At the same time as, or after, the thing under the arrangement is done there needs to be:

- a material decrease in market value
- of at least one post-CGT share
- which is held by the controller of the company or an associate of the controller.

This share (together with any other post-CGT share held by the controller or associate which decreases in value under the share value shift, whether or not the decrease is material) is called the decreased value share. The decreased value shares do not have to be the shares in relation to which something is done under the arrangement. *[New subparagraph 160ZZRM(1)(b)].*

5.24 The meaning of a material decrease is explained below.

5.25 A share includes an interest in a share, and a right or option (contingent or otherwise) to acquire a share or an interest in a share *[New subsection 160ZZRM(4)].*

5.26 A post-CGT share is a share acquired by the shareholder on or after 20 September 1985 *[New subsection 160ZZRM(6)].*

5.27 The meanings of controller and associate are explained below.

5.28 The holder of a share will be a controller of the company for these purposes even if not the controller at the time of the value shift, provided that the holder was the controller at some time during the course of the arrangement (from the time it was entered into to the end of the share value shift). For instance, if a person who controls the company enters into an arrangement under which a share value shift is to take place in relation to shares held by that person after control is passed to another person, the value shifting provisions may apply in relation to decreased value shares held by the former controller. *[New paragraph 160ZZRL(b)].*

5.29 An example of where a decrease in value of a share occurs at the same time as the thing under the arrangement is done is in a share buy-back at less than market value. In such a case there is a relevant decrease in the value of the shares bought back even though the decrease occurs at or immediately before the time at which they are bought back.

5.30 Because of the requirement that there be a decrease in value of the share, a share which is acquired for more than market value will not be a decreased value share even though it results in the increase in value of other shares held in the company. This is because the market value of the newly acquired share immediately after the issue would be the same as its market value at the time of its issue (its market value is not directly affected by the amount paid for it). However, although new Division 19B would not operate to adjust the cost base of the newly issued shares, if the parties to the share issue are not dealing at arm's length subsection 160ZH(9) of the Act will reduce the consideration paid for the shares to their market value. As explained below, shares issued for *less than* market value are specifically included as increased value shares.

*(iii) Share value shift: increased value share*

5.31 In addition to the material decrease in value of a decreased value share, for a share value shift to occur there needs to be, at the same time as, or after, the thing under the arrangement is done:

- an increase in market value of another share or other shares in the company held by the person who holds a decreased value share, or by an associate of that person; or
- at least one new share in the company issued to the person who holds a decreased value share, or to an associate of that person, where the market value of that new share exceeds any consideration (money or property) given for it.

Each of these shares is called an increased value share. The increased value shares do not have to be the shares in relation to which something is done under the arrangement. *[New paragraph 160ZZRM(1)(c)]*

5.32 In the case of the issue of a new share, the increase in market value of the share for the purposes of the value shifting provisions is the amount by which the market value of the new share exceeds any consideration given for it *[New subparagraph 160ZZRM(1)(c)(ii)]*.

5.33 The increase in value of the increased value shares does not have to be the same as the decrease in value of the decreased value shares. Nor does the increase have to be a material increase.

5.34 It is not necessary for the kind of share which comprises the decreased value shares to be the same as the kind which comprises the increased value shares. For example, the decreased value shares may constitute options to acquire shares while the increased value shares may be interests in shares.

**(iv) Share value shift: nexus**

5.35 There needs to be a nexus between the decrease and the increase in market value of the shares involved in the share value shift. Therefore purely coincidental decreases and increases will not trigger the share value shifting provisions. The required nexus is that it must be reasonable to conclude that doing the thing in relation to the share or shares caused (in whole or part) the decrease in value of the decreased value shares and the increase in value (or creation) of the increased value shares. This is an objective test and may be satisfied whether or not the decrease and increase or creation were intended. *[New paragraph 160ZZRM(1)(d)]*

5.36 If the decrease and/or increase in market value of the shares which occurs after something is done under the arrangement was caused partly by doing the thing and partly by some unconnected event, the share value shifting provisions apply only to that part of the increase or decrease that was caused by the thing done under the arrangement *[New subsection 160ZZRM(2)]*.

**(v) Controller of a company**

5.37 A taxpayer is a controller of a company if the taxpayer meets one of three control tests:

- **Strict control test.** Under this test, the taxpayer, together with associates of the taxpayer, owns or is entitled to acquire a control interest of at least 50% in the company. The sum of the interests of an entity and its associates in the company is referred to as the associate inclusive control interest. The meaning of associate and associate inclusive control interest is explained below. *[New paragraph 160ZZRN(1)(a)]*
- **Assumed controller test.** This test is satisfied if the taxpayer owns, or is entitled to acquire, an associate inclusive control interest of at least 40% in the company, unless the company is controlled by a party (referred to as an ‘entity’) or parties (referred to as a ‘group of entities’) unrelated to the taxpayer or to any associate of the taxpayer and including neither the taxpayer nor any associate of the taxpayer *[New paragraph 160ZZRN(1)(b).]*

The expressions ‘entity’ and ‘group’ are to have the same meaning as in Part X of the Act, which deals with controlled foreign companies. In this regard, Part X provides that:

- ‘entity’ means a company, a partnership, a person in the capacity of trustee or any other person; and
- ‘group’ includes one entity alone or a number of entities the members of which are not in any way associated with each other nor acting together, and so is not

restricted to a number of entities which are associated or are acting together [*New subsection 160ZZRN(2)*].

- **De facto control test.** This test is satisfied if the taxpayer and the taxpayer's associates do effectively control the company. If the taxpayer can, for example, control the appointment of directors of a company, the taxpayer will generally be taken to have de facto control of the company. [*New paragraph 160ZZRN(1)(c)*]

5.38 It is possible for there to be more than one controller of a company (for instance, because associates together have strict control, assumed control or de facto control). A controller can be a company or a natural person.

5.39 The tests require ascertainment of interests held in a company. In most cases an interest in a company will be held in the form of shares. Interests in a company include those held directly or indirectly. At a particular time, a taxpayer's interests in a company include the interests the taxpayer holds in the company as well as the interests the taxpayer is entitled to acquire in the company.

5.40 To determine whether a taxpayer has an associate inclusive control interest in a company (see below), the interests of the taxpayer's associates in the company are also relevant.

5.41 The following paragraphs explain what interests in a company are taken into account in the tests for determining whether a company is controlled for value shifting purposes. These tests are based on those contained in Division 3 of Part X of the Act for determining whether a foreign company is a controlled foreign company. The modifications which have been made to the Part X tests are explained after the explanation of how the tests operate.

#### **Direct control interests in a company**

5.42 A direct control interest that a taxpayer has in a company is calculated as the greatest of the percentages that the taxpayer holds, or is entitled to acquire, of the following:

- the total paid-up share capital in the company;
- the total rights to vote, or to participate in any decision making, in relation to:
  - the distribution of capital or profits;
  - the changing of the constituent documents;
  - the varying of the share capital of the company;

- total rights to distributions of capital or profits of the company on winding-up; or
- total rights to distributions of capital or profits of the company other than on winding-up.

5.43 In calculating a taxpayer's direct control interests in a company, shares referred to as eligible finance shares in the company are not taken into account. These are, generally, shares issued under preference shares financing arrangements with Australian financial intermediaries (such as banks) and their subsidiaries. In effect, they stand in place of loans.

**Indirect control interest in a company**

5.44 A taxpayer may hold a direct control interest in an entity (entity A) which holds a direct control interest in another entity (entity B). In this case the taxpayer has an indirect control interest in entity B.

5.45 A taxpayer's indirect control interest in entity B is obtained by multiplying the direct control interest of the taxpayer in entity A by the entity's direct control interest in entity B. This process of multiplication is continued where there are further entities in the chain.

**Deeming rules for tracing an indirect control interest**

5.46 For the purpose of determining the indirect control interest in an entity a taxpayer or an interposed entity is deemed, in specified circumstances, to own a 100% interest in a lower tier entity. These circumstances are described in the following chart:

<b>Direct control interest of taxpayer together with associates</b>	<b>Interest deemed to be</b>
A taxpayer has an interest of at least 50% in a company	100%
A taxpayer satisfies the assumed controller test in relation to a company	100%
A taxpayer actually controls the company	100%
A taxpayer is a partner in a partnership	100%
A taxpayer has interest of at least 50% in a trust	100%

**Associate inclusive control interest**

5.47 A taxpayer's associate inclusive control interest in a company is the sum of the taxpayer's:

- direct control interests in the company;
- indirect control interests in the company;
- associates' direct control interests in the company; and
- associates' indirect control interests in the company.

5.48 In calculating a taxpayer's associate inclusive control interest in a company, double counting of a direct control interest or an indirect control interest held by the taxpayer and the taxpayer's associates is rectified by special provisions.

**Modifications of the Part X tests of control**

5.49 The above tests for determining whether a taxpayer has an associate inclusive control interest of a certain amount are modified versions of the control tests contained in Division 3 of Part X. The modifications (which have been incorporated in the explanation provided above) are described below. *[New subsection 160ZZRN(3)]*.

5.50 The expression ‘company’ in Part X does not include a company in the capacity of trustee. However, the tests of control provided in Part X of the Act are applied to determine whether a taxpayer is the controller of a company for value shifting purposes even if the company acts in the capacity of a trustee *[New paragraph 160ZZRN(4)(a)]*.

5.51 Subsection 349(4) deals with the tracing of control through chains of entities and provides that, for tracing of interests, an entity is in certain circumstances deemed to hold a 100% control interest in another entity. The Bill applies this provision to the tracing of control interests in a company. *[New paragraph 160ZZRN(4)(b)]*.

5.52 Subsections 350(6) and 350(7) deal with the case where a company is controlled by a group of 5 or fewer Australian entities. These rules will not apply in determining, in the value shifting provisions, whether a taxpayer controls a company. *[New paragraph 160ZZRN(4)(c)]*

5.53 Subsection 352(2) provides that an indirect control interest can only be traced through an interposed entity if the entity is a controlled foreign entity. This test is modified so that an interposed entity is not to be taken into account in calculating an indirect control interest unless the entity is:

- a company of which the taxpayer or associate is a controller;
- a partnership; or
- a trust.

*[New paragraph 160ZZRN(4)(d)]*

5.54 Section 354 provides that each partner in a controlled foreign partnership is treated as having a 100% control interest in the partnership in tracing control of another entity through the partnership. This rule is to be applied in the share value shifting provisions in tracing control through any partnership and not only through controlled foreign partnerships. *[New paragraph 160ZZRN(4)(e)]*.

5.55 Section 355 sets out rules that apply to the tracing of control interests through a controlled foreign trust. These rules are to be applied in the share value shifting provisions to tracing of interests through all trusts. However, the special rule in subsection 355(1), that an eligible transferor in relation to a controlled foreign trust holds a control tracing



interest of 100% in the trust, will not apply to the value shifting provisions. *[New paragraphs 160ZZRN(4) (c) and (f)].*

**(vi) Associate**

5.56 For the purpose of the value shifting provisions, the expression 'associate' is to have the same meaning as in Part X of the Act *[New subsection 160ZZRN(2)].*

5.57 The determination of who are the associates of an entity proceeds in four parts. The first part deals with associates of an individual. The second deals with associates of a company, the third with associates of a trustee and the fourth with associates of a partnership. When an entity acts in the capacity of a trustee, the part dealing with the associates of a trustee will determine the associates of that entity in that capacity.

**Part 1 - Associates of an individual**

5.58 The associates of an individual (other than an individual acting in the capacity of a trustee) are:

- relatives of the individual, as follows:
  - the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of the individual or of his or her spouse (including de facto); and
  - the spouse (including de facto) of the individual or any other person mentioned above;
- a partner of the individual or a partnership of which the individual is a partner;
- the spouse (including de facto) or child of a partner, where the partner is also an individual (other than an individual acting in the capacity of a trustee);
- the trustee of a trust, where the individual or another entity that is an associate of the individual by virtue of this Part benefits under the trust; or
- a company where that company is sufficiently influenced by:
  - the individual; or
  - another entity that is an associate of the individual because of the rules in this Part; or
  - another company which is sufficiently influenced by the individual; or
  - two or more of the above entities; or

- a company where the capacity to cast or control greater than 50% of the maximum votes at a general meeting of the company is held by:
  - the individual; or
  - associates of the individual under the rules in Part 1; or
  - the individual and the associates.

**Part 2 - Associates of a company**

5.59 Part 2 deals with the associates of a company (company A). The associates of company A include:

- a partner of company A;
- a partnership of which company A is a partner;
- where a partner of company A is a natural person otherwise than in the capacity of a trustee, the spouse or child of the partner;
- the trustee of a trust where company A, or an entity that is an associate of company A under Part 2, benefits under the trust;
- an entity (entity B) that exerts sufficient influence over company A or holds a majority voting interest in company A. The influence may be exerted by entity B alone or together with other entities. The majority interest may be held by entity B alone or together with entities that would be associates of entity B if it is treated as if it were company A and the first three Parts of the tests for associates applied to it;
- a company (company C) that is sufficiently influenced by company A or in which company A holds a majority voting interest. The influence may be exerted by company A alone or together with other entities that are sufficiently influenced by company A or in which company A hold majority voting interests. The majority voting interests may be held by company A alone or together with entities that are associates of company A as determined under Part 2 of the tests for associates; and
- any other entity (entity D) that would be an associate of a third entity (entity E) which would be an associate of company A if the associates of entity E are determined treating it as if it were company A and applying the first three parts of the tests for associates.

Majority voting interest

5.60 An entity holds a majority voting interest in a company where:

- the entity's direct shareholding in the company, and
- the entity's indirect shareholding in the company (for example through a subsidiary),

amount to 50% or more of the maximum number of votes that might be cast at a general meeting of the company. An example is where a company has a wholly owned subsidiary which has a 75% voting interest in another company. Both the parent and subsidiary would be associates of the third company. This is because the subsidiary has a majority voting interest in the third company and the parent has a majority voting interest in the subsidiary.

#### Sufficient influence

5.61 An entity is sufficiently influenced by a second entity or other entities if the entity is accustomed or under an obligation or might reasonably be expected to act in accordance with the directions, instructions or wishes of the second entity or other entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts).

#### **Part 3 - Associates of a trustee**

5.62 The associates of a trustee are:

- any entity that benefits under the trust;
- any entity that is an associate, under Part 1 or Part 3, of an individual who benefits under the trust; or
- where a company is an associate of the trustee under either of the two above dot points, an entity that would be an associate of the company under Part 2 or Part 3.

#### Rules relating to public unit trusts

5.63 In applying the tests for associates, the trustee of a public unit trust is treated as if it were a company. Special rules apply in order to determine whether a public unit trust is sufficiently influenced by another entity or whether an entity has a majority voting interest in the public unit trust.

5.64 Generally, a public unit trust will be sufficiently influenced by another entity or entities where the trust is accustomed to act or is under an obligation to act or might reasonably be expected to act in accordance with the directions, instructions or wishes of the entity or entities.

5.65 The concept of a 'majority voting interest' in relation to public unit trusts will be determined by reference to the corpus or income of the trust. If an entity is entitled to, or is entitled to acquire, 50% or more of the income or corpus of the trust then the entity is considered to hold a majority voting interest in the public unit trust. Corresponding rules apply to test whether a group of entities have a majority voting interest in the trust.

**Part 4 - Associates of a partnership**

5.66 The associates of a partnership are:

- a partner in the partnership;
- where the partner is an individual, any entity which would be an associate under Part 1 or Part 3 of that individual; or
- where the partner is a company, any entity which would be an associate of the company because of Part 2 and Part 3.

***(vii) Material decrease in value***

5.67 The share value shifting provisions will only apply if the decrease in market value of at least one of the decreased value shares is material. A particular decrease (referred to in new subsection 160ZZRO(1) as the current decrease) in market value of a share under a share value shifting arrangement will be material if:

- it is 5% or more of the total market value of the share immediately before the decrease, or if it is one of a number of decreases under the arrangement and the sum of all the decreases (whether before or after the current decrease) is 5% or more; or
- the total decrease in market value of all the decreased value shares held by the controller or associate is \$100,000 or more.

***[New subsection 160ZZRO(1)]***

5.68 The share value shifting provisions apply to the whole of a material decrease, not just to that part of the decrease which exceeds the thresholds outlined above.

5.69 Under a particular value shifting arrangement there may be a series of decreases in value of a share, each decrease being part of the one arrangement. In such a case the sum of all the decreases is used to determine whether there is a material decrease in value. Therefore if, for instance, a share value shift takes place in two stages so that first there is a 6% decrease in the market value of a share and then, some time later, a 4% decrease in the same share, the whole of the decrease, whether taken

individually or cumulatively, will be taken into account for the purposes of the value shifting provisions.

5.70 Although it is a requirement before the share value shifting provisions apply that the decrease in market value of at least one of the decreased value shares be material, it is not necessary that the increase in market value of any of the increased value shares be material. However, as explained below, certain consequences for an increased value share follow only if the increase is material.

#### **(b) Operation of share value shifting provisions**

5.71 Where the above prerequisites are met so that the value shifting provisions apply, the Bill provides what the consequences are for the shares whose market value decreases (the decreased value shares) where the decrease is material, and for the shares whose market value increases materially. The consequences depend on whether the increased value shares are pre-CGT or post-CGT shares.

5.72 A pre-CGT share is a share which was acquired by the shareholder before 20 September 1985 [*New subsection 160ZZRM(5)*]. A post-CGT share is a share which was acquired by the shareholder on or after 20 September 1985 [*New subsection 160ZZRM(6)*].

##### *(i) Consequences of value shift to pre-CGT share*

5.73 The operative provisions described below (*subsections 160ZZRP(2) and (3)*) apply if any of the increased value shares is a pre-CGT share. [*New subsection 160ZZRP(1)*]

5.74 If those operative provisions apply, the consequences are as follows:

- there may be a deemed capital gain; and
- there is a reduction in the cost base, indexed cost base or reduced cost base of the decreased value shares.

These are explained below. There is no adjustment to the cost base of the pre-CGT increased value shares because those shares do not have a cost base.

##### **Deemed capital gain**

5.75 In relation to each decreased value share for which there was a material decrease, the holder will be deemed to receive a capital gain equal to the amount by which the consideration calculated under *new subparagraph 160ZZRP(2)(a)(ii)* exceeds (if at all) the proportion of the cost base or indexed cost base of the share calculated under *new*

*subparagraph 160ZZRP(2)(a)(iii)*. No capital loss will arise if the proportion of the cost base used against the decrease is more than the amount of that decrease. *[New subsection 160ZZRP(2)]*.

5.76 The consideration referred to above is the amount of the (material) decrease in value of each decreased value share which is referable to the increase in value of the pre-CGT increased value shares. This is calculated by multiplying the total decrease in market value of each of the decreased value shares by the proportion of the total market value increase (as defined) which is attributable to the pre-CGT increased value shares. *[New subparagraph 160ZZRP(2)(a)(ii)]*

5.77 The total market value increase is the sum of:

- all increases in market value of all increased value shares (i.e. shares held by the controller or associate, or associate of that person, which increase in value pursuant to a share value shift as defined in new section 160ZZRM); and
- all increases in market value of all other shares where the requirements of a share value shift under new section 160ZZRM are satisfied but for the fact that the shares are not increased value shares because they are not held by the controller or associate, or associate of that person.

*[New subsection 160ZZRO(3)]*

5.78 For example, if there are:

- 200 *decreased value shares* held by the *controller*, each of which decrease in market value by \$40 from \$100 to \$60; and
- 50 *increased value shares* which are *pre-CGT* shares of the controller which increase in value by \$80 from \$20 to \$100;
- 50 increased value shares which are *post-CGT* shares held by an *associate* of the controller which increase in value by \$40 from \$20 to \$60; and
- 50 increased value shares which are *post-CGT* shares held by a *third party*, unassociated with the controller, which also increase in value by \$40 from \$20 to \$60

then, since the decrease in value referable to the increase in the post-CGT shares held by the associate and third party are not taken into account for new section 160ZZRP purposes, the consideration in respect of each decreased value share will be:

$$\frac{\$80 \times 50 \text{ (pre-CGT shares)}}{[\$80 \times 50 \text{ (pre-CGT shares)}]} + [\$40 \times 100 \text{ (other increasing shares)}] = \$20$$

*[New subparagraph 160ZZRP(2)(a)(ii)]*

5.79 The cost base used against the decrease is calculated by multiplying:

- the amount that would have been the cost base or indexed cost base of the share if it had been disposed of immediately after the decrease; by
- the same proportion that the decrease in the market value of the share referable to the pre-CGT increased value shares bears to the market value of that share immediately before the decrease.

*[New subparagraph 160ZZRP(2)(a)(iii)].*

5.80 In the example provided above, if the amount that would have been the indexed cost base of each of the decreased value shares is \$60, then the cost base used against the consideration would be:

$$\frac{\$20}{\$100} \times \$60 = \$12$$

This would result in a capital gain of \$8 in respect of each decreased value share in relation to the value shifted into the pre-CGT increased value shares.

5.81 In determining the amount that would have been the cost base or indexed cost base of a decreased value share if it had been disposed of immediately after the decrease, any previous application of *new subsection 160ZZRP(3)* (see below) should be taken into account. For instance, if:

- there are a number of material decreases in value under one share value shifting arrangement, and
- a reduction would be made to the cost base or indexed cost base under new subsection 160ZZRP(3) in relation to previous decreases,

then the cost base or indexed cost base to be used for the purposes of *new subparagraph 160ZZRP(2)(a)(iii)* in relation to a subsequent decrease in value is what would have been the cost base or indexed cost base of the share as reduced by new subsection 160ZZRP(3). This is because new subsection 160ZZRP(3) states that it applies for the purposes of any application of Part IIIA to a later disposal of the decreased value share, which must include for the purposes of application of new subparagraph 160ZZRP(2)(a)(iii).

5.82 *New subsection 160ZZRP(2)* operates on the assumption that a part of the decreased value share is disposed of. If a company disposes of an asset to another company in the same company group, roll-over relief

may be available under section 160ZZO of the Act. However, roll-over relief is not available in relation to capital gains accruing on share value shifting transactions because, although there is a presumed disposal of part of the share, there is no deemed acquisition such that it can be said that part of the share has been disposed of to a particular taxpayer (for instance, a company within the same company group).

5.83 Any capital gain accruing under *new subsection 160ZZRP(2)* (i.e. in relation to the shift in value to pre-CGT shares) will be additional to any capital gain accruing under *new subsection 160ZZRQ(2)* (i.e. in relation to the shift in value to post-CGT increased value shares held by another person). Therefore, in relation to the example explained above, the controller will incur a further capital gain in relation to the value shifted to the shares held by the associate. This is explained below.

**Adjustment to acquisition consideration etc. for decreased value share**

5.84 Whether or not there is a deemed capital gain, a reduction is to be made to the cost base, indexed cost base or reduced cost base of the decreased value shares for the purposes of a subsequent disposal (including a disposal for *new subparagraph 160ZZRP(2)(a)(iii)* purposes). This reduction prevents a capital loss being generated, or a capital gain being reduced, by the value shifting transactions. [*New subsection 160ZZRP(3)*].

5.85 The reduction is made in relation to each decreased value share for which there was a material decrease in value by reducing:

- the consideration and other expenditures which, immediately before the decrease in value took place, would comprise the cost base, indexed cost base or reduced cost base of the share under section 160ZH of the Act; by
- the same proportion that the decrease in the market value of the share referable to the increase in market value of the pre-CGT increased value shares bears to the market value of that share immediately before the decrease.

5.86 The result is, therefore, that there is a reduction to what would be the cost base, indexed cost base or reduced cost base by an amount equivalent to the cost base calculated under new subparagraph 160ZZRP(2)(a)(iii) which would be used against the consideration received for the deemed disposal if that subsection applied (i.e. the \$12 calculated in the above example). The approach of reducing each of the expenditures comprising the cost base rather than directly reducing the cost base as a whole is adopted since, on a later disposal of the share, the cost base is calculated by reference to the consideration and other expenditures in section 160ZH.



5.87 *New subsection 160ZZRP(3)* can apply successively to a number of decreases in value under a share value shift arrangement or arrangements. Moreover, the cost base reduction calculated under the subsection is additional to any cost base reduction calculated under new subsection 160ZZRQ(3). Therefore, in the example outlined above, the expenditure comprising the indexed cost base of the decreased value shares will be further reduced by reference to the value shifted into the post-CGT shares held by the associate. This is explained below.

*(ii) Consequences of value shift to post-CGT shares*

5.88 The operative provisions described below (*new subsections 160ZZRQ(2) to (6)*) apply if at least one of the increased value shares is a post-CGT share. Any post-CGT increased value shares will be held by the controller, an associate of the controller, or, if that associate holds a decreased value share, an associate of the associate. [*New subsection 160ZZRQ(1)*]

5.89 If those operative provisions apply, the consequences are as follows:

- there may be a deemed capital gain in relation to the decreased value shares held by someone other than the holder of the increased value shares [*New subsection 160ZZRQ(2)*];
- the cost base, indexed cost base or reduced cost base of the decreased value shares are reduced [*New subsection 160ZZRQ(3)*]; and
- subject to certain conditions, there is an increase in the cost base, indexed cost base or reduced cost base of the increased value shares [*New subsections 160ZZRQ (4) to (6)*].

**Deemed capital gain**

5.90 As with shifts of value into pre-CGT shares, if value is shifted from shares held by a taxpayer to shares held by another person, the taxpayer will not be subject to CGT in relation to capital gains accrued on the value shifted when the increased value shares are disposed of. Therefore it is necessary to subject that gain to CGT at the time of the shift in value.

5.91 Therefore *new subsection 160ZZRQ(2)* determines any capital gain that may arise in relation to the decreased value shares which suffer a material decrease to the extent that value is shifted from those shares into post-CGT increased value shares held by another person. To achieve this, the subsection identifies the decreased value shares to which it applies as 'different person shares'. These are decreased value shares held by a person other than the person who held a particular post-CGT increased

value share. Because a share value shift requires that increased value shares be held by the same person as the holder of decreased value shares or an associate of that person, the holder of a different person share will always be an associate of the holder of an increased value share. Moreover, since new Division 19B only applies in relation to a material decrease in value, a different person share must be one whose decrease in value is material. *[New paragraph 160ZZRQ(2)(a)]*

5.92 The capital gain in relation to a different person share is calculated in the same way as a capital gain in relation to a shift in value to pre-CGT shares under new subsection 160ZZRP(2). The gain is equal to the amount by which the consideration calculated under new *subparagraph 160ZZRQ(2)(a)(iv)* exceeds (if at all) the proportion of the cost base or indexed cost base calculated under new *subparagraph 160ZZRQ(2)(a)(v)*. Once again, no capital loss can arise under the subsection. *[New subsection 160ZZRQ(2)].*

5.93 The consideration referred to above is the amount of the decrease in value of each different person share which is referable to the increase in value of the post-CGT increased value shares held by the different person. This is calculated by multiplying the decrease in market value of each of the different person shares by the proportion of the total market value increase (as defined above) which is attributable to those post-CGT increased value shares. *[New subparagraph 160ZZRQ(2)(a)(iv)]*

5.94 In the example provided above in paragraph 5.78 the decreased value shares would be different person shares in relation to the increased value shares held by the associate. Therefore, since there are 50 increased value shares held by the associate which increase in value by \$40, the consideration in respect of each of the decreased value shares (which decrease in value by \$40) would be:

$$\frac{\$40 \times 50 \text{ (increased value shares held by associate)}}{[\$80 \times 50 \text{ (pre-CGT shares)}]} + [\$40 \times 100 \text{ (other increasing shares)}] = \$10$$

*[New subparagraph 160ZZRQ(2)(a)(iv)]*

5.95 The cost base or indexed cost base used against the decrease is calculated by multiplying:

- the amount that would have been the cost base or indexed cost base of the different person share if it had been disposed of immediately after the decrease; by
- the same proportion that the decrease in its market value which is attributable to the post-CGT increased value shares held by the

different person bears to its market value immediately before the decrease.

**[New subparagraph 160ZZRQ(2)(a)(v)].**

5.96 In the example in paragraph 5.78 above, assuming a \$60 indexed cost base for the decreased value shares, the cost base to be used in determining the capital gain would be:

$$\frac{\$10}{\$100} \times \$60 = \$6$$

This would result in a capital gain of \$4 in respect of each decreased value share in relation to the value shifted into the post-CGT increased value shares held by the associate. It would be added to the \$8 capital gain in relation to the shift to the pre-CGT increased value shares, giving a total capital gain for the share value shift of \$12. The cost base of the shares involved in the share value shift will also be adjusted, as explained below.

5.97 There is no deemed capital gain in relation to the value shifted into post-CGT shares from decreased value shares which are held by the same person. These decreased value shares are called 'same person shares', which, like different person shares, must suffer a material decrease in value. There is no immediate capital gain liability in relation to this shift in value because any capital gain that had accrued in relation to the value shifted is not shifted out of the person's shareholding (or into CGT-exempt, pre-CGT shares). By making the cost base adjustments described below to the shares involved in the value shift, CGT is deferred until the capital gain is realised by disposing of those shares.

**Adjustment to acquisition consideration etc. for decreased value share**

5.98 The amount of the reduction to the components comprising the cost base, indexed cost base or reduced cost base of the decreased value shares (both different person and same person shares) in relation to the shift in value to post-CGT shares is calculated in the same way as where the increased value shares are pre-CGT (i.e. if new subsection 160ZZRP(3) had applied to the transaction). These components are reduced by the same proportion that the decrease in the market value of the shares referable to the post-CGT increased value shares bears to the market value of those shares immediately before the decrease. **[New subsection 160ZZRQ(3)]**

5.99 In the example described above in paragraph 5.78, if the decreased value shares were disposed of immediately after the value shift the original \$60 indexed cost base of each of the decreased value shares would be reduced by \$6 under new subsection 160ZZRQ(3). This is the cost base used against the consideration in calculating the capital gain for new subsection 160ZZRQ(2) purposes. Combined with the cost base

reduction under new subsection 160ZZRP(3) (explained above), the total reduction to the indexed cost base of each decreased value share would be \$18, giving a new indexed cost base (for the purposes of an immediate disposal) of \$42.

**Adjustment to cost base expenditure for increased value share**

5.100 An adjustment is also made to the cost bases of the increased value shares provided the increase is material. *[New subsection 160ZZRQ(4)]*

5.101 The test of whether an increase is material is equivalent to the test of whether a decrease is material. Therefore a particular increase (referred to in new subsection 160ZZRO(2) as the current increase) in market value of a share under a share value shifting arrangement will be material if:

- it is 5% or more of the total market value of the share immediately before the increase, or if it is one of a number of increases under the arrangement and the sum of all the increases (whether before or after the current increase) is 5% or more; or
- the total increase in market value of all the increased value shares held by the controller or associate is \$100,000 or more.

If the increased value share is a new share issued at less than market value, the increase in market value for the purposes of new Division 19B (i.e. the difference between market value and the consideration paid) will be material if it is 5% or more of the market value of the share as soon as it comes into existence. Therefore, if no consideration is paid for the share, the increase will be material.

*[New subsection 160ZZRO(2)]*

5.102 The increase is made to prevent the same gain being taxed twice. However, because the value shift referable to different person shares is subject to an immediate CGT liability, while that referable to same person shares is not, the increase in the cost bases of the increased value shares which relates to different person shares will usually be greater than the increase in relation to the value shift from same person shares. Therefore, although the reduction in the cost bases of both different person and same person shares is the same, the increase to the cost base of the increased value shares is determined as the sum of two amounts, being the amount referable to different person shares and the amount referable to same person shares. *[New subsection 160ZZRQ(4)]*

5.103 Broadly speaking, subject to the limits explained below, the cost base, indexed cost base or reduced cost base of each of the post-CGT increased value shares is increased by the sum of:

- so much of the increase in value as is attributable to different person shares *[New paragraph 160ZZRQ(5)(a)]*; and

- the amount that, if the shift in value from the same person shares had been subject to an immediate CGT liability, would have been the cost base used against the deemed consideration in respect of those shares [*New paragraph 160ZZRQ(6)(c)*].

This ensures that, on disposal of the post-CGT increased value shares:

- there will be no capital gain in relation to the shift in value from the different person shares (because any such gain is liable to CGT at the time of the value shift); and
- any capital gain that would have been realised at the time of the value shift if the shift had been to shares held by another person will be realised at the time of the disposal of the increased value shares.

5.104 The increase in the cost base of the increased value shares is attributable to the value shifted out of the decreased value shares. In this regard it is akin to expenditure of a capital nature incurred by a taxpayer for the purpose of enhancing the share's value. Therefore the increase is deemed to be expenditure of that kind. [*New subsection 160ZZRQ(4)*]

**Deemed expenditure referable to decreased value shares of different person**

5.105 The amount of the increase in market value of a particular post-CGT increased value share which is referable to the value shifted from different person shares is obtained by multiplying the total increase in value by the same proportion that the decrease in value of all different person shares bears to the total decrease in value of all decreased value shares. Although the decrease in value of each different person share is, by definition, a material decrease, the total decrease in value of all decreased value shares is not restricted to material decreases of those shares. [*New paragraph 160ZZRQ(5)(a)*]

5.106 The increase in market value must be reflected in the market value of the increased value share at the time of its disposal. To the extent that it is not, the relevant cost base will not be increased. For instance, if the material increase in value of the increased value shares was attributable to extra dividend or voting rights and, at the time of their disposal, the shares no longer had those increased rights, there would be no increase of the cost base, indexed cost base or reduced cost base. [*New paragraph 160ZZRQ(5)(a)*].

5.107 Moreover, the increase to the relevant cost base cannot exceed the sum of the amounts of the decrease in market value of all the different person shares which is referable to the increase in value of the particular increased value share. This is because any excess would not represent a shift of value from the decreased value shares into the increased value shares. [*New paragraph 160ZZRQ(5)(b)*].

5.108 In the example provided in paragraph 5.78 above, it is only the increased value shares held by the associate that would have an increased cost base. This is because the shares held by the third party are not 'increased value shares'. The increase in cost base of the increased value shares held by the associate would be determined under new subsection 160ZZRQ(5) since the decreased value shares are different person shares. The increase to the indexed cost base would be the amount of the actual increase in value because the whole of the increase in market value is attributable to different person shares.

**Deemed expenditure referable to decreased value shares of same person**

5.109 Since there is no immediate capital gain in relation to the value shift referable to same person shares, the cost base increase to the increased value shares as a result of the value shift from those shares will usually be less than if the shifted value had been subject to CGT at the time of the shift. Essentially, subject to the limits described below, the cost base increase will be the amount that would have been the cost base used against the consideration deemed to have been received in relation to the value shift if the shifted value had been subject to CGT at the time of the shift (i.e. if the value shift had been to shares held by another person or to pre-CGT shares). This ensures that, when any increased value share is sold, the capital gain that would have been realised at the time of the value shift from the same person shares (i.e. the difference between the amount of the value shifted into the share and the cost base attributable to that shifted value) will be subject to CGT at the time of the disposal. [*New paragraph 160ZZRQ(6)(c)*]

5.110 To determine the cost base increase to the increased value shares as a result of the value shift from same person shares, it is necessary to apply the calculation provided in new subsection 160ZZRQ(3) to same person shares. Under this calculation, in relation to each same person share, the components comprising the cost base, indexed cost base or reduced cost base of that share is reduced by the fraction in new paragraph 160ZZRQ(3)(b). For the purposes of the application of *new paragraph 160ZZRQ(6)(c)*, this fraction is the proportion of the total market value increase which is attributable to the particular increased value share multiplied by the percentage reduction in value of the same person share. The sum of the reductions of each same person share is the amount by which the cost base, indexed cost base or reduced cost base of the increased value share is to be increased under new subsection 160ZZRQ(6). [*New paragraph 160ZZRQ(6)(c)*]

5.111 As with the shift in value from different person shares, the increase in the cost base, indexed cost base or reduced cost base of the increased value shares referable to the value shift from same person shares cannot exceed:

- the extent to which the increase in value referable to the same person shares is reflected in the increased value shares at the time of their disposal [New paragraph 160ZZRQ(6)(a)]; or
- the total decrease in value of the same person shares which is referable to the increase in value of the post-CGT increased value shares [New paragraph 160ZZRQ(6)(b)].

### **Keeping of records**

5.112 The Bill proposes to amend section 160ZZU of the Act to ensure that a person subject to the share value shifting provisions is required to retain sufficient records to enable calculation of any capital gain and cost base adjustments which arise by virtue of the share value shift. This includes:

- details of the essential features of the value shifting arrangement (including dates of the decreases);
- the amounts of the decreases in market value of the decreased value shares;
- the amounts of the increases in market value of the increased value shares, and other shares which would be increased value shares if held by the controller or associate, or associate of the holder of the decreased value shares; and
- any amount that would have been the cost base of the decreased value shares if disposed of at the time of the share value shift.

*[Clause 24 - substituted paragraph 160ZZU(1)(b)].*

