Tax Working Group Public Submissions Information Release

Release Document

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

[2] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

APPENDIX 2(A): Capital Gains Tax Simplified Example

Scenario

- Jo Co Ltd is owned by Jo
- Jo put $600,000 capital into Jo Co Ltd when she created it.
- Jo Co Ltd used this to buy a small commercial building to rent for $500,000.
- Ten years later the tenant offered $650,000 for either the shares in Jo Co Ltd or the building.
- Because Jo's personal circumstances had changed Jo accepted the offer and sold her shares.

The CGT

- At year ten Jo Co Ltd has made a gain of $150,000 on the shares and paid CGT of $50,000 (using a simplified 33.333% tax rate).
- At year ten Jo Co Ltd has an asset (the building) which cost it $500,000, but which is now worth $650,000. If Jo Co Ltd sold the building and liquidated the company there would be another CGT tax bill of $50,000. This is double tax of the one $150,000 gain.

Comment

- This is a very simplistic example. Real life situations will be much more complicated, and there are many similar scenarios that could cause this set of problems.
- Similar problems could arise if instead Jo Co Ltd sold the building. However, in this case Jo could avoid the double taxation by causing Jo Co Ltd to pay out the net capital gain as an imputed dividend.
- This series of transactions could be restructured, but a CGT should not dictate structuring.
- Superficially we could attribute the increase in the share value into the asset. However, this only works where 100% of the shares are sold at the same time. Think about multiple owners with only some selling up.
- Also, multiple use of one loss could be a result.
- Anecdotally we have heard that these scenarios created real problems in Australia and caused a significant fiscal loss.

APPENDIX 2(B): Capital Gains Tax Example: Roll-over relief

Roll-over relief

Where an asset is sold (say to a 3rd party) any gain or loss is clear. However, where it is sold to a person who is associated the Tax Act often teats these transactions differently in recognition of, among other things, the fact that real ownership may not have changed. For tax purposes, where roll-over relief applies, the acquirer assumes the tax cost base of the disposer of the asset. This has the effect of deferring any taxations consequences of the change of ownership. Note that it is only a deferral, and eventually the tax consequences will be suffered (or enjoyed, if the effect is a deduction).

Simplified example

An asset cost $5,000,000 and is now worth $6,500,000

Situations in which roll-over relief will be requested (or be necessary) include:

- The asset changes ownership under a matrimonial property settlement (the Tax Act already has a roll-over that makes these events a tax book value transaction so that there is no income tax);
- A spouse inheriting the asset under a will (the Tax Act already has a roll-over that generally makes these events a tax book value transaction so that there is no income tax);
- The asset is a farm that the children of a farmer inherit upon the death of the parents (a CGT could actually force the sale of the family farm in some circumstances);
- The asset is a commercial building which is insured for replacement cost, which is destroyed by say an earthquake – tax on the capital gain (and with replacement insurance there almost always is a capital gain) would mean that the building couldn't be replaced like for like;
- The asset is sold within a group of companies – economic ownership hasn't changed and there should only be a CGT when the asset is sold outside the group of companies
- The asset is a stepping stone farm which the farmer sells to buy a bigger farm;

In all these examples except the last one it is reasonable to argue that there has not been, from an economic perspective, a real change of the ownership of the asset to a 3rd party. Thus no "real" gain that has been realised that should be taxed.

A Similar, but more nuanced argument could be made in respect of the last argument – the business is ongoing and has merely increased its net assets.