

# TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

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## UPDATE 19 | COVID-19 Restructuring

COVID-19 restructuring – use this crisis as a planning opportunity.

### COVID-19 Restructuring

When it comes to restructuring, the law hasn't changed. The small business CGT concessions, the 50% CGT discount and the CGT rollovers and exemptions apply as before. The law didn't change. But circumstances did.

Maybe in the past you didn't qualify for the small business CGT concessions. Maybe because your turnover was over \$2m. Or maybe because the market value of your business and other assets was over \$6m and hence too high.

But while you might not have qualified for the small business CGT concessions before, you might now.

And if you do, you could use the small business CGT concessions to lock in your capital gains with little or no tax to pay and get a higher cost base. A higher cost base now means a lower capital gain and hence less tax later on.

### COVID-19 Restructuring

So in this update let's look at the planning opportunities that come out of the current crisis – the subdued market values and the decimated turnovers.

As you know to qualify for the small business CGT concessions you need to pass either the turnover test (\$2m) or the maximum net asset value test (\$6m).

The turnover test is for an entire year and hence might not be low enough yet to qualify.

But the maximum net asset value test is just a point in time, just before the CGT event. And so that market value might be low enough at the moment to qualify for the small business CGT concessions.

Your business is usually your main asset in the maximum net asset value test. The test does not take your family home and super into account. So it is all about your business' market value.

But how do you determine this value. How can you get below the \$6m mark. Andrew Henshaw of Velocity Legal in Sydney shares some thoughts with you in this episode.

Here is what we learned but please listen in as Andrew explains all this much better than we ever could.

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## Why Market Value

Your business market value is important for two reasons. You need the market value to:

a – Pass the maximum net asset value test. Market value less liabilities is the net value of your CGT assets (s152-20 ITAA97). And if this net value is \$6 million or less just before the CGT event, you satisfy the maximum net asset value test.

b – Determine capital proceeds. The market value substitution rule often kicks in when you restructure. If the seller and buyer are not dealing at arm's length (and you often don't in a restructuring), then the market value substitution rule just takes market value as your capital proceeds to determine your capital gain.

## What Market Value

Market value is not defined in our tax legislation (ITAA36 or ITAA97) and so you have to go back to its ordinary meaning and relevant court decisions, especially the following four court cases – Spencer Case –

### The Spencer Case

The High Court established in the Spencer case – *Spencer v The Commonwealth of Australia (1907) 5 CLR 418* – that the market value of an asset is what a purchaser is reasonably expected to pay in an arm's length transaction, where the purchaser is willing but not anxious to buy and the seller is willing but not anxious to sell.

And that in this 'hypothetical market', the parties would be aware of current market conditions and be fully informed of the asset's advantages and disadvantages.

So this is the starting point.

### The McCathie Case

In the McCathie case – *McCathie v Federal Commissioner of Taxation [1944] HCA 9* – the High Court held that the fact that parties considered that 'the outlook for the future of the retail trade' was ominous was a relevant factor.

The next case confirms this position.

### The Elder's Trustee Case

In the Elder's Trustee case – *Elder's Trustee & Executor Co Ltd v Higgins [1963] HCA 48* – the High Court held that unusual circumstances (wartime conditions) may affect the valuation. In that case, it was accepted that in the particular circumstances of the taxpayers, the land values were low due to an economic depression.

So you can assume lower market values stemming from the current crisis.

### The Miley Case

The Miley case – *Commissioner of Taxation v Miley [2017] FCA 1396* – confirmed two things. Hypothetical market is irrelevant if there is an actual transaction in a real market. And no apportioning of market value between shares and restraint to trade.

The company had three equal shareholders who all sold their respective shares to an arm's length purchaser for \$17.7m in total. Mr Miley was one of those shareholders.

The problem was that Mr Miley had other assets that took him over the \$6m mark. So he tried to reduce the value of his company shares to get below.

He argued that his position as a minority shareholder reduced the market value of his share in a hypothetical market where his share alone was sold. So the market value should be determined as a hypothetical sale, not an actual sale.

The AAT agreed and applied a 16.7% discount to the \$5.9m, reducing the value of his shares 'just before' the CGT event to \$4,914,700. The Federal Court rejected Mr Miley's arguments and overturned the AAT decision.

The Federal Court argued that the fact that there was a buyer who was ready and willing to purchase all of the shares (including Mr Miley's minority shares) was 'a reality of the market' and the terms and circumstances of the CGT event itself must not be ignored. And so the Federal Court found that the market value is the actual purchase price. And not some hypothetical value.

Mr Miley had entered into a restraint of trade as part of the contract. He argued that the \$5.9m should be apportioned between the value of the shares and the value of the restraint, reducing the value of his shares. But the AAT rejected this argument – *Miley v Commissioner of Taxation (Taxation) [2019] AATA 5540*.

### **The Hookey Case**

And the Hookey case confirms what the Miley case had already established. Real life overrides hypothesis.

In the Hookey case – *Hookey v Commissioner of Taxation [2018] AATA 1509* – the taxpayer – let's call him Mr Hookey – sold five child learning centres in 2007/08.

Mr Hookey argued that the buyer had been anxious [...and stupid] and so had paid a lot more than the centres had been worth.

The AAT argued that prima facie the market value is the purchase price, unless the purchaser was 'wholly erroneous, and affected by error'. The onus of proof is on the tax payer. Mr Hookey failed to bring this proof. So he lost.

### **Summary**

So for your COVID-19 restructuring, get a valuation from a qualified and independent valuer. This especially applies to goodwill and equity interests in private companies, since these assets are unique and illiquid.

Expect a lower value due to the current crisis. And check whether this lower value will allow you to qualify for the small business CGT concessions.

If it does, consider COVID-19 restructuring to increase your cost base with little or no tax to pay. But of course never do this just for tax reasons. Always have another reason up your sleeve.

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