The Tax Institute

The Tax Summit

The Tax Summit

Session 10.4: Mergers & Acquisitions – Navigating Tax Uncertainty

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1. Introduction[1]

This paper examines three areas of tax law bearing on the current Australian M&A landscape:

- First, we consider the foreign resident capital gains tax (**CGT**) changes proposed by the *Treasury Laws Amendment (Strengthening Accountability for Tax Adviser Misconduct and Other Measures) Bill 2026* – including the expanded definition of 'real property', changes to the ‘principal asset test’ and the new process requirements under the foreign resident CGT withholding regime (see **Section 3**).
- Second, we examine the current tax treatment of contingent consideration and earnout arrangements, tracing the ATO's 'separate asset' approach through to the concessional look-through earnout regime, and the persisting difficulties that arise in dealing with non-qualifying arrangements, including the application of the ‘taxation of financial arrangements' regime to such arrangements, as illustrated by the recent Full Federal Court decision in *Merchant v Commissioner of Taxation* [2025] FCAFC 56 (***Merchant***) (see **Section 4**).
- Third, we consider the use of CGT roll-overs in the context of recent M&A transactions, including the recent merger of Brickworks Limited and Washington H. Soul Pattinson and Company Limited, and the scheme of arrangement involving Millennium Services Limited. We also discuss the ATO's much anticipated guidance on back-to-back roll-overs, and the Full Federal Court's decision in *AusNet Services Ltd v Commissioner of Taxation* [2025] FCAFC 21 (***AusNet***) (see **Section 5**).

Before turning to these substantive topics, we survey the tax landscape across Australian public M&A transactions announced in FY26 and summarise the key tax related themes observed throughout the year.

[1] The author gratefully acknowledges the invaluable research and assistance of Coco Frohlich, a solicitor at Herbert Smith Freehills Kramer, for this paper.

2. FY26, a year in review

In FY26, there were 57 transactions announced to the market (comprising 33 schemes of arrangement and 24 takeovers). Several noteworthy tax themes emerged from this dataset.[2]

1. Scrip for scrip roll-over relief – still the number one tax ask

Scrip for scrip roll-over relief remained the most sought-after tax outcome in public M&A during FY26. Of the 14 confirmed applications for ATO class rulings across scheme transactions, 11, or nearly 80%, related to the availability of CGT scrip for scrip roll-over relief under Subdivision 124-M of the ITAA 1997. Notable examples included Aurumin Ltd's acquisition by Brightstar Resources (CR 2026/3 and CR 2026/4), Seven West Media's merger with Southern Cross Media Group (CR 2026/9), and Winsome Resources' acquisition by Li-FT Power (CR 2026/32). Of the 14 confirmed class ruling applications, 8 (or 57%) involved a foreign bidder, compared to 6 involving an Australian bidder, suggesting that foreign acquirers were driving roll-over ruling activity.

2. Special dividends – expected to remain in vogue

Eight deals (or 14% of all transactions) involved the payment of a special dividend by a target to improve the purchaser's offer by allowing qualifying shareholders to benefit from franking credits attaching to the dividend. Looking ahead, the announced changes to capital gains taxation in the 2026-27 Federal Budget – including a minimum 30% tax on capital gains and the replacement of the CGT discount with indexation for capital gains accruing after 1 July 2027 – are only likely to buttress this trend.

As the effective tax rate on capital gains increases, fully franked special dividends may become a more prominent feature of scheme structures going forward.

From a tax perspective, the payment of a special dividend by a target company in connection with a scheme of arrangement typically gives rise to two key tax issues for target shareholders: (i) does the special dividend form part of the 'capital proceeds' received by a shareholder for the disposal of their shares in the target company; and (ii) do the franking credits attaching to the special dividend pass to target shareholders:[3]

- **Capital proceeds:** Based on the ATO's practice, a special dividend will generally form part of a shareholder's capital proceeds where the purchaser participates in the funding of the dividend or where the payment of the dividend is a condition precedent to the scheme becoming effective. Where the special dividend forms part of capital proceeds, it will reduce any capital loss that a shareholder would otherwise have made on the disposal of their shares, and – where CGT scrip for scrip roll-over is available – will be treated as 'ineligible proceeds', reducing the cost base of the replacement interests received by the shareholder.

- **Qualified person rules:** For a shareholder to be entitled to the benefit of franking credits attaching to a special dividend, the shareholder must be a 'qualified person' for the purposes of former Division 1A of Part IIIAA of the ITAA 1936. Where the scheme consideration is reduced by the amount of the special dividend, the ATO's consistent practice is to treat the payment of the special dividend as a 'related payment', requiring the shareholder to satisfy the stricter 'secondary qualification period' (broadly, holding the shares 'at risk' for at least 45 days during the period beginning 45 days before, and ending 45 days after, the ex-

[2] All legislative references in this paper are to the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) or the *Taxation Administration Act 1953* (Cth) (**TAA**), as the context requires, unless otherwise indicated.
[3] These issued are discussed in more detail in an earlier paper, Joseph Power and Jay Prasad, 'Capital Management and M&A (presented at The Tax Summit in October 2022), see, in particular, section 5.

dividend date). As a practical matter, this means the scheme timetable must be carefully implemented so that the ex-dividend date falls at least one day before the scheme record date.

- **Exempting entity:** Where the purchaser is foreign-owned or controlled, there is a risk that the target will become an 'exempting entity' (within the meaning of s 208-25 of the ITAA 1997) before the special dividend is paid, in which case, based on the ATO's practice, Australian resident shareholders may not be entitled to the benefit of the franking credits unless the dividend is paid before the scheme record date.

- **Equity funded dividend rule:** A special dividend will be 'unfrankable' where it is reasonable to conclude that the principal effect, and a more than incidental purpose, of an issue of equity interests (by the target, the bidder or another entity) was to fund, directly or indirectly, a substantial part of the dividend. The ATO recently finalised a Practical Compliance Guideline (**PCG**) on its approach to this integrity rule, following the release of a draft PCG in December 2024. In the PCG, the ATO maintains that where a bidder funded loan (sourced partly from a capital raising) is used by a 'private company' to pay a pre-sale dividend in the context of a private equity buyout – and the capital raising and distribution are intended to facilitate the shareholder's exit (rather than the payment of the dividend) – the ATO will regard this arrangement as falling within the Green Zone. In a separate example, however, a pre-sale dividend paid by a public company – which had undertaken a fund raising 12 months earlier – in connection with a scheme of arrangement confirms that the ATO would **not** consider the dividend as falling in the 'Green Zone'. The ATO's distinction between private company buyouts (which may fall within the Green Zone) and public company transactions (which will not) remains difficult to reconcile with the text of the legislation, although it finds some support in the explanatory materials. In practice, we are continuing to see undertakings and representations in scheme implementation deeds to help manage this risk, as well as target companies approaching the ATO to confirm the availability of franking credits for pre-sale dividends paid in connection with a scheme.

A further – and, in our view, underappreciated – complexity for the target company arises where it borrows from a third party lender to fund the payment of a special dividend, where the target company is subject to the thin capitalisation rules and relies on the third-party debt test (**TPDT**) for determining its debt deductions. One of the conditions of the TPDT in Subdivision 820-EAB of the ITAA 1997 is that the borrower must use "all, or substantially all" of the proceeds of issuing the relevant debt interest to fund its "commercial activities in connection with Australia'" (section 820-427A(3)(d)). In TR 2025/2, the ATO has expressed the view that paying a distribution to shareholders does not constitute a 'commercial activity' for these purposes, and that debt borrowed to fund such a distribution – which, by extension, could include debt borrowed to fund a special dividend in connection with a sale transaction – will not satisfy this condition. Based on the ATO's position, interest on the relevant debt would not be deductible under the TPDT. We consider the ATO's views on this issue to be incorrect.[4] Nevertheless, care should be taken by target companies looking to debt fund a special dividend.

3. Tax as a hard condition precedent — an exception, not the rule

Despite the high volume of ATO ruling applications in FY26, parties generally resisted making a tax ruling a condition precedent to a transaction. Only 2 of the 33 scheme transactions in FY26 included a tax ruling as a condition precedent, meaning the deal could not proceed without the ruling being obtained. Those two examples were Qoria Ltd's scheme with Auria Consolidated Group (which required Qoria to obtain a draft class ruling confirming scrip for scrip roll-over relief) and Atlantic Lithium's proposed scheme with Zhejiang Huayou

[4] For a detailed analysis of the TPDT conditions and the ATO's interpretation of the 'commercial activities' requirement, see Ryan Leslie, 'Thin Capitalisation — Third party debt test rules, emerging issues and ATO guidance' (paper presented at The Tax Institute Infrastructure & Investments Tax Conference, Sydney, 12–13 June 2025). See also, Michael O'Meara SC, 'Keynote Address: Thin Capitalisation - Third Party Debt Test: Background, operation and issues in interpretation' (paper presented at The Tax Institute Infrastructure & Investments tax Conference on 18 – 19 June 2026).

Cobalt (which required a private ruling from the Commissioner-General of the Ghana Revenue Authority, not the ATO, before the transaction could proceed).

The far more common approach, seen in approximately 16 schemes, was a 'soft' provision, such as an undertaking or reasonable endeavours obligation on the target to apply for a ruling, cooperation and review rights for the bidder, or simply an acknowledgement that the target may approach the ATO.

4. Demerger and acquisition schemes — ATO's views confirmed

The Peel Mining / Aeris Resources transaction was notable for confirming the ATO's view that demerger roll-over relief is not available where a demerger occurs in connection with a sale transaction. The transaction involved the demerger by Aeris of Spectre Metals Limited (the ATO denied demerger relief in CR 2026/41) followed by Aeris acquiring Peel under a scrip transaction – that is, a ‘spin / merge’ structure (the availability of scrip for scrip roll-over was confirmed in CR 2026/42). The ATO did accept that the demerger distribution comprised entirely a return of capital (with no dividend component). The transaction is a timely reminder that spin / merge structures remain possible despite the ATO's now settled (but strained) views on demerger acquisition structures generally, provided the deal economics work without demerger relief.

5. Takeovers and class rulings — rarely seen, but a notable exception; and ESS rulings

Takeovers rarely gave rise to ATO class rulings. In fact, only 1 of the 24 takeovers in FY26 resulted in a class ruling – a rate of approximately 4%. That was the PointsBet / betr Entertainment transaction, where a class ruling (CR 2026/10) confirmed the tax treatment for shareholders participating in an off-market selective share buy-back conducted following the close of the takeover. The buy-back appeared designed to give betr shareholders an alternative path to exit – offering them the opportunity to liquidate their shares through the buy-back rather than participating in the scrip offer under the takeover itself. The ATO ruling confirmed the new off-market share buy-back tax rules applied to betr (a listed public company), such that no part of the buy-back proceeds was taken to be a dividend for tax purposes.

Finally, one transaction in FY26 gave rise to a separate employee share scheme (**ESS**) class ruling. In Seven West Media's merger with Southern Cross Media Group, a separate ESS ruling (CR 2026/18) was obtained alongside the main scrip for scrip roll-over ruling (CR 2026/9), reflecting the need to address the tax treatment of target employee equity plan holders receiving scrip consideration.

3. Changes to foreign resident CGT rules

3.1 Background

In 2006, Australia's foreign resident CGT rules were significantly amended following the passage of the *Tax Laws Amendment (2006 Measures No. 4) Act 2006* (Cth), which inserted a new Division 855 into the ITAA 1997 and repealed the precursor provisions in Division 136. The 2006 amendments represented a deliberate policy choice to narrow Australia's CGT base in order to attract foreign investment. As explained in the Revised Explanatory Memorandum, the 2006 changes represented an attempt to more narrowly define Australia's CGT base by reference to the notion of 'taxable Australian property' (**TAP**) and to 'enhance Australia's status as an attractive place for business and investment' by aligning the taxation of capital gains or losses derived by foreign residents more closely with OECD practice.[5]

Following the introduction of Division 855 into the ITAA 1997:

- in 2009, clarifying amendments were made to the definition of 'taxable Australian real property' (**TARP**) to expressly include a lease over land.[6] The amendment applied to CGT events happening on or after 20 May 2009, the date on which the amendment was first foreshadowed;
- in 2012, a further amendment was made to the definition of TARP in subsection 855-20(b) to refer to 'minerals' as a new defined term; and[7]
- in 2016, a related purchaser withholding regime was introduced through the insertion of a new Subdivision 14-D into Schedule 1 of the TAA.[8] The withholding rate was initially set at 10%[9], increased to 12.5%[10] and is currently 15%.

Following a period of relative stability, the Government signalled an intention in the 2024-2025 Federal Budget to "strengthen the foreign resident capital gains tax (CGT) regime to ensure foreign residents pay their fair share of tax in Australia and to provide greater certainty about the operation of the rules."[11] The measure was intended to ensure that Australia "can tax foreign residents on direct and indirect sales of assets with a close economic connection to Australian land, more in line with the tax treatment that already applies to Australian residents."[12]

Treasury released a consultation paper on the proposed changes in July 2024.[13]

Following deferral of the measure in the 2025-2026 Budget,[14] Treasury released exposure draft legislation on 10 April 2026, ahead of the 2026-2027 Budget announcement on 12 May 2026.[15] Notwithstanding the relatively modest pronouncements in the 2024-2025 Budget, the exposure draft contained significant amendments to the existing foreign resident CGT regime, including the related withholding regime.

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[5] [4.5]-[4.6].
[6] See *Tax Laws Amendment (2009 Measures No. 4) Bill 2009* (Cth).
[7] See *Tax Laws Amendment (2011 Measures No. 9) Bill 2011* (Cth).
[8] *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* (Cth).
[9] *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* (Cth).
[10] *Treasury Laws Amendment (Foreign Resident Capital Gains Withholding Payments) Bill 2017* (Cth).
[11] Australian Government, Budget 2024-2025, *Budget Measures – Budget Paper No. 2*, p. 17.
[12] Ibid.
[13] Australian Treasury, 'Strengthening the foreign resident capital gains tax regime – Consultation paper' (July 2024).
[14] Australian Government, Budget 2025-2026, *Budget Measures – Budget Paper No. 2*, p. 16.
[15] *Exposure Draft – Treasury Laws Amendment Bill 2026: Strengthening the Foreign Resident CGT Regime* (**Exposure Draft**).

Among other things, the Exposure Draft signalled an intention to materially expand Australia's CGT base by expanding the definition of 'real property' for Division 855 purposes beyond its general law meaning to include any interest or right in Australian land and anything fixed on Australian land. Most alarmingly, this change was proposed to apply retrospectively from 12 December 2006 (when Division 855 first came into effect) based on the theory that the intended operation of the law was to always capture things fixed to land regardless of their status at law. The retrospectivity was, in our view, especially inappropriate given only a few months prior to the release of the exposure draft legislation, Hespe J in *YTL Power Investments Limited v Commissioner of Taxation* [2025] FCA 1317 held that 'real property' in Division 855 takes its general law meaning, as did Colvin J in *Newmont Canada FN Holdings ULC v Commissioner of Taxation (No 2)* [2025] FCA 1356, each after considering the legislative history and statutory context (these decisions are discussed further below).

The Exposure Draft was released with a (very short) public consultation period of two weeks, following which the *Treasury Laws Amendment (Strengthening Accountability for Tax Adviser Misconduct and Other Measures) Bill 2026* (**Bill**) was introduced into Parliament on 2 July 2026.

Despite the short public consultation window, the Exposure Draft attracted an extensive response, with a chorus of submissions from foreign institutional investors, peak industry bodies and professional services firms identifying structural gaps and practical difficulties that, in several respects, went beyond the concerns outlined at the time of the 2024-25 Budget announcement.

The Bill as introduced addresses some of these concerns – most significantly by abandoning the proposed retrospective application of the expanded 'real property' definition – but left others unresolved, some of which are discussed below. Further, while the abandonment of the retrospectivity of the amendments is welcomed, it is disappointing that Treasury did not accept industry feedback about grandfathering arrangements for investments made prior to commencement of the changes; that aspect of retrospectivity was maintained.

Overall, the proposed changes are likely to impact investment returns for foreign investors, particularly in respect of investments with significant physical assets, including in the energy, infrastructure, mining and data centre sectors, where the changes may mean that assets that were previously outside Australia's CGT net – for example, because the relevant rights were characterised as personal property under State or Territory legislation – are now subject to the rules. This will have implications for new investments, but also the valuation of existing assets, which will now reflect the embedded tax cost of a future disposal.

From a tax policy design perspective, a concern raised by the Investor Group on Climate Change (**IGCC**) and Infrastructure Partnerships Australia in their submissions to Treasury was the competitive gap created by the 30% CGT rate applicable to foreign investors. Australian superannuation funds investing in the same renewable energy and infrastructure assets, they argued, are subject to an effective CGT rate of approximately 10%, reflecting the concessional tax treatment available to complying superannuation funds.

The proposed 30% rate for foreign investors is therefore more than double the rate applicable to their domestic counterparts in respect of the same assets. The absence of any related changes to Australia's 'managed investment trust' (**MIT**) regime means that many assets now within the scope of the foreign resident CGT rules will remain outside the scope of the concessional MIT regime.

It is likely that the overall effect of these measures, including their potential impact on Australia's attractiveness for foreign investment, will not be fully understood for some time.

3.2 Existing foreign resident CGT rules

The existing rules in Division 855 of the ITAA 1997 permit a foreign resident (or a trustee of a foreign trust) to disregard a capital gain or capital loss from a CGT event happening in relation to a CGT asset that is not TAP.[16]

Section 855-15 sets out five categories of TAP which, relevantly for present purposes, includes:

- 'taxable Australian real property' TARP;[17] and
- a CGT asset that is an 'indirect Australian real property interest' (**IARPI**) but that is not covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).[18]

TARP is defined as follows:[19]

- real property situated in Australia (including a lease of land, if the land is situated in Australia); or
- a mining, quarrying or prospecting right (to the extent that the right is not real property), if the minerals, petroleum or quarry materials are situated in Australia.

Notably, 'real property' is not currently a defined term in the income tax legislation (unlike in a GST context) – a gap that, as we explain below, has given rise to significant litigation.

Under the current rules, a membership interest held by an entity (the 'holding entity') in another entity (the 'test entity') will be an IARPI if at a particular time:

- the interest passes the 'non-portfolio interest test' (which broadly tests whether the holding entity holds a 10% or greater direct interest, on an associate-inclusive basis, in the test entity)[20] at that time or throughout a 12 month period that began no earlier than 24 months before that time and ended no later than that time;[21] and
- the interest passes the 'principal asset test' (**PAT**) at that time,[22] which broadly tests whether the market value of the test entity's underlying assets, held directly or indirectly, is principally (i.e. more than 50%) derived from TARP.[23]

3.3 Key proposed changes: 'real property' and TARP

Overall, the effect of the changes proposed by the Bill will be to materially expand Australia's CGT base by broadening the concept of 'real property' for Division 855 purposes, thereby narrowing the range of circumstances in which a foreign resident will be entitled to disregard a capital gain or loss under Division 855.

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[16] Section 855-10.
[17] Section 855-15, Table (Item 1).
[18] Section 855-15, Table (Item 2).
[19] Section 855-20.
[20] The non-portfolio interest test is contained in section 960-195 and incorporates the notion of a 'direct participation interest' as defined in s 960-190, which itself incorporates the notion of a 'direct control interest' per ss 350 and 351 of the ITAA 1936. However, for Division 855 purposes, the definition of 'direct control interest' is subject to the modifications set out in s 855-25(2). Broadly, these modifications exclude any relevant rights which a holding entity is 'entitled to acquire' with respect to the test entity from the calculation of their direct participation interest (for example, voting or distribution rights which an entity is 'entitled to acquire' through the exercise of an option to acquire shares).
[21] Section 855-25(1)(a).
[22] Section 855-25(1)(b).
[23] Section 855-30.

Under the proposed changes, 'real property' will become a defined term for income tax purposes, including for the purposes of certain provisions outside of Division 855 which also use that term.[24]

'Real property' will be defined in s 995-1(1) to 'include' the following:

(a) any interest in or right over land (regardless of how that interest or right is treated for the purposes of any State law or Territory law);

(b) a personal right to call for or be granted any interest in or right over land;

(c) a licence or contractual right exercisable over or in relation to land;

(d) a thing (or combination of things) that is fixed or installed on land (whether or not it is a fixture, or treated in any other way, for the purposes of any State law or Territory law or at general law);[25]

(e) a lease of a thing mentioned in paragraph (d);

(f) a licence or contractual right exercisable over a thing mentioned in paragraph (d).[26]

The definition of TARP will also be amended to include:

- real property situated in Australia, relating to land situated in Australia, or relating to a thing (or combination of things) fixed or installed on land situated in Australia;
- a water entitlement in relation to a water resource situated in Australia; and
- an option or right to acquire a CGT asset covered by any of the preceding paragraphs of the definition of TARP.[27] (Note, however, an option or right to acquire a CGT asset which is an IARPI is **not** a category of TARP).

The Explanatory Memorandum to the Bill (**Bill EM**) explains that the amendments are intended to address "a gap that has emerged between the intended and actual operation of the regime, particularly with State and Territory laws being interpreted to affect the ordinary meaning of real property as currently used in the foreign resident CGT regime."[28]

The broader context of the amendments is a series of disputes in which the Commissioner has, unsuccessfully, argued that 'real property' as used in the current formulation of Division 855 takes its 'ordinary meaning'.

As explained further below, based on the Commissioner's arguments in those cases, the term 'real property' is broader than it has been traditionally understood in a technical, legal sense and encompasses, for example, *any* buildings, infrastructure or equipment which is fixed or installed on land. This contention has been expressly rejected by the Federal Court on two occasions, with Hespe and Colvin JJ finding, in separate decisions discussed below, that 'real property' in the current formulation of Division 855 contemplates its technical, general law (rather than 'ordinary') meaning. As those decisions reiterate, 'real property' at general law describes an interest or estate with respect to land, rather than physical property. As such, in the case of physical assets fixed or installed on land, it is necessary to carefully analyse the underlying rights to ascertain the legal status of the asset – a mere physical connection to land, for example, will not always suffice to bring it

[24] Bill, sch 2, Items 1-10.
[25] Note that the equivalent limb in the Exposure Draft was more confined than in the Bill, referring to "a thing (or combination of things) that is fixed or installed on land <u>and is, or is reasonably expected to be, situated on the land for the majority of its useful life</u> (whether or not it is a fixture, or treated in any other way, for the purposes of any State law or Territory law or at general law)" (emphasis added).
[26] Bill, sch 2, Item 20.
[27] Bill, sch 2, Item 15.
[28] Bill EM, [2.13].

within the general law definition of 'real property', particularly where State or Territory legislation purports to 'sever' that asset from any underlying rights in respect of the land.

The proposed changes in the Bill will undoubtedly reverse the confining effect of these two decisions – a point we return to below.

3.3.1 YTL Power

Background

In *YTL Power Investments Limited v Commissioner of Taxation of the Commonwealth of Australia* [2025] FCA 1317 (***YTL Power***), Hespe J found against the Commissioner in concluding that a foreign resident investor was entitled to disregard a capital gain of around AUD $948 million arising from the disposal of 33.5% of the shares in ElectraNet Pty Ltd (**ElectraNet**), an Australian resident company.

By way of background, ElectraNet has since 2000 privately operated the South Australian electricity transmission network.

Under this arrangement, the transmission infrastructure is owned by a South Australian statutory corporation (**TLC**), which 'leases' the infrastructure (**Leased Assets**) to ElectraNet under a series of contractual agreements and related statutes. The Leased Assets are variously located on land owned by either TLC, ElectraNet or third party landowners.

Importantly, the South Australian legislation governing the privatisation arrangement contains a 'severance' provision which provides as follows:

> Electricity infrastructure or public lighting infrastructure the subject of a transfer order, vesting order, sale/lease agreement or special order is to be taken to be transferred, vested or leased (as the case may be) by the order or agreement as if the infrastructure were personal property severed from any land to which it is affixed or annexed and owned separately from the land.[29]

Meaning of 'real property'

The Commissioner's central argument in *YTL Power* was that the Leased Assets were TARP, on the basis that 'real property' as used in Division 855 should be understood according to its 'ordinary meaning' as something akin to immovable property, and which includes "reference to the physical attributes of an item of property and included an item that was a structure that was physically affixed to land.'[30] This broad definition would, if accepted, capture the Leased Assets, being infrastructure that was physically affixed to land.

This submission was expressly rejected by Hespe J, who considered that 'real property' has an exclusively technical meaning as a legal term of art.[31] Further, her Honour concluded that the legislature did not intend to depart from this technical meaning, having regard to the use of the term throughout the ITAA 1997 and in many of Australia's tax treaties, as well as the deliberate broadening of the definition in s 855-20(a) to include a lease of land (which would ordinarily be excluded from the technical meaning of 'real property') by way of a subsequent legislative amendment.[32]

Her Honour also rejected the Commissioner's submissions that the Leased Assets were fixtures at general law and therefore automatically part of the underlying land, affirming that items affixed to land do not automatically

[29] *Electricity Corporations (Restructuring and Disposal) Act 1999* (SA) (**Disposal Act**) s 30.
[30] *YTL Power*, [108].
[31] Ibid, [123]-[136].
[32] Ibid, [133]-[134].

become ‘fixtures’ in the relevant technical sense. As such, it was necessary to undertake a careful analysis of the precise rights conferred in relation to the Leased Assets, including the impact of the South Australian severance legislation.[33]

Application to Leased Assets

Leased Assets on third party land

In relation to the Leased Assets located on third party land, ElectraNet was granted a statutory ‘easement’ and other contractual rights to enter the land and access the infrastructure. Hespe J considered that this ‘easement’ was not an easement at general law (not being a right in servitude of a dominant tenement) and was not ‘real property’. When considering the precise bundle of rights granted under the relevant legislation, it was clear that the rights were not “rights of exclusive and unrestricted use” but were instead for a limited specified statutory purpose, and did not confer on ElectraNet an estate or interest in land.[34]

Under the relevant agreements, where TLC held a private easement over third party land, ElectraNet acquired an equal undivided share in that easement and obtained a lease of TLC’s undivided interest. Her Honour noted that at least some of the access arrangements under the private easements possibly conferred an interest in ‘real property’, although the terms of the private easements were not before the Court.[35]

In any event, pursuant to the terms of the Disposal Act and other relevant legislation governing the privatisation arrangement, the electricity infrastructure was not owned by the third party landowner. Any rights conferred by the private easements were rights of access to third party land and did not carry with them the right to use, lease, or operate the electricity transmission infrastructure that had been placed on that land. Her Honour also considered that any rights of access did not give rise to a lease in the third party land, being, rather, “statutory right[s] of occupation for statutory purposes”.[36]

Leased Assets on land held by TLC

In relation to the Leased Assets located on land held by TLC, the underlying land was leased to ElectraNet pursuant to a separate ‘Land Lease’ as part of the privatisation arrangement, and that lease of the land conferred on ElectraNet an interest that was real property. However, the transmission infrastructure on TLC's land was leased to ElectraNet pursuant to the ‘Network Lease’, and by virtue of s 30 of the Disposal Act, the infrastructure was taken to be leased as personal property severed from the land. The express effect of the severance provision was that the Network Lease did not confer on ElectraNet any interest or estate in the underlying land of TLC.

Her Honour rejected the Commissioner’s submissions that the broad deeming effect of the severance provision should be confined, noting that it was “open to the Commonwealth legislature to provide a definition of real property that denied the effect of s 30 of the Disposal Act”[37], as the amendments in the Bill now propose to do.

Leased Assets on land held by ElectraNet

Lastly, in relation to Leased Assets located on land already owned by ElectraNet, her Honour reiterated that the severance provisions deemed any rights granted to ElectraNet to be personal property severed from the

[33] Ibid, [141]-[150]. As a procedural matter, the parties agreed to proceed on the assumption that, absent the severance provisions under South Australian law, the rights granted to ElectraNet with respect to the Leased Assets would have conferred an interest in land amounting to ‘real property’ for Division 855 purposes (an assumption, which, it should be noted, Hespe J considered was not free from doubt). As such, the decision has limited direct application to asset classes not subject to the same statutory regime.
[34] Ibid, [155]-[157].
[35] Ibid, [162].
[36] Ibid, [165].
[37] Ibid, [187].

underlying land. That is, despite ElectraNet's ownership of the underlying land, the effect of the severance provision was unqualified in that for all purposes, and regardless of who was the actual registered proprietor, the Leased Assets were severed from the land.[38]

As such, no additional rights in the nature of real property (and therefore TARP) were granted to ElectraNet.

3.3.2 Newmont

Background

YTL Power was closely followed by the decision in *Newmont Canada FN Holdings ULC v Commissioner of Taxation (No 2)* [2025] FCA 1356 (***Newmont***), in which Colvin J considered whether two foreign resident companies within the broader Newmont group were entitled to disregard a capital gain of around AUD $96 million arising from the disposal of 29% of the shares in an Australian resident company (**Newmont Australia**) as part of a restructure.

The Newmont group conducts gold mining activities in Australia through various joint ventures.

At the time of the share sale, the main assets of Newmont Australia and its subsidiaries were associated with gold mining operations at four mines in Western Australia and the Northern Territory and included plant and equipment, mining information (geological information about specific sites) and mining tenements held under the relevant State or Territory mining legislation. Newmont Australia and its subsidiaries also held freehold and leasehold interests in some of the land where the mining tenements were located and various other assets.

One aspect of the dispute in *Newmont* centred around complex valuation questions arising from the PAT. As a procedural matter, the parties agreed on a list of twenty-three questions to be determined by Colvin J, with several valuation issues still to be determined by a referee.

Meaning of 'real property'

Similar to the submissions made in *YTL Power*, the Commissioner again argued that 'real property' should be understood according to its 'ordinary' meaning rather than its technical legal meaning, encompassing in effect, "both land and anything erected on or attached to land."[39]

Colvin J held that 'real property' should be understood according to its technical legal meaning, although his Honour was prepared to accept – unlike Hespe J – that 'real property' did have an 'ordinary' meaning separate from its legal use. However, his Honour was not convinced that even the ordinary meaning of 'real property' was as broad as the Commissioner contended, finding:

> Both at law and in ordinary parlance, buildings, structures and other things erected on or attached to land become real property in a derivative way. They do not have the character of real property in a way that is separate and distinct from the land itself. Rather, it is because they are seen to be part of the immovable character of the land that they are described as real property. Further, it is ownership of the land that is viewed as the source of the property interest in the things that are erected on or attached to the land.[40]

Colvin J referred to several authorities, including the High Court of Australia's decision in *TEC Desert Pty Ltd v Commissioner of State Revenue* (WA) [2010] HCA 49 (***TEC Desert***), which considered the general principles applicable to construction of legal terms of art appearing in legislation. His Honour held that there existed a rule

[38] Ibid, [193]-[194].
[39] *Newmont*, [570].
[40] Ibid, [573].

of construction to the effect that “words that have acquired a legal meaning are to be given that meaning unless a contrary intention is clearly expressed having regard to matters of context.”[41]

Considering the context of Division 855, ‘real property’ was clearly intended to be understood according to its technical legal meaning, for reasons including the following:

- The explanatory memorandum to the Bill introducing Division 855 described the amendments as aligning tax practice “with Australia’s treaty practice” and “OECD practice” by “narrowing the range of assets on which a foreign resident is subject to Australia’s CGT to Australian real property...”. His Honour considered that the reference to treaties and OECD practice suggested an intention to apply the legal meaning, as the OECD model convention on tax treaties specifically referred to ‘immovable property’ having “the meaning which it has under the law of the Contracting State in which the property in question is situated”.[42]

- The express objects of Division 855, as set out in s 855-5, referred to ensuring that capital gains “remain subject” to Australian capital gains tax laws if a relevant entity’s underlying value is principally derived from Australian real property, invoking an understanding of the previous capital gains tax regime. Colvin J was not convinced that the extrinsic materials or the Division 855 objects “manifested an intention to impose a liability to taxation based upon a conception of real property that was unconfined by recognised legal principle”.[43]

- The express inclusion of ‘a lease of land’ within the definition of TARP served to confirm an intention to deploy the narrow legal meaning, as the amendment would otherwise have been unnecessary.[44] Similarly, the specific inclusion of a ‘mining, quarrying or prospecting right’ as a separate category within the definition of TARP suggested an intention to deploy the narrow meaning, as otherwise the inclusion would have been unnecessary.[45]

Colvin J was also not persuaded by the Commissioner’s arguments as to the significance of the phrase ‘ordinary meaning’ in the explanatory memorandum to the 2006 Bill (that is, “Taxable Australian real property generally refers to real property, within the ordinary meaning of that term, that is situated in Australia*”*), finding:

> I am not persuaded that much can be made of the use of the expression ‘ordinary meaning’ in that context. It is quite likely that it could be referring to the fact that ‘real property’ is not statutorily defined but ‘mining, quarrying or prospecting right’ is so defined. It is possible also that it could be referring to ordinary legal meaning. The aspects of the explanatory memorandum that refer to alignment with OECD practice would support that conclusion.[46]

Interestingly, and, we would say, somewhat stubbornly, the Bill EM nonetheless doubles down on the view that ‘real property’ in the existing Division 855 was always intended to bear its ‘ordinary’ meaning:

> Prior to the amendments, the term ‘real property’ was not expressly defined in the income tax law (unlike the statutory definition in the GST context) and the income tax law relied on real property having its ordinary meaning. The Explanatory Memorandum to the *Tax Laws Amendment (2006 Measures No. 4) Bill 2006*, which inserted Division 855 into the ITAA 1997, made clear that TARP refers to real property ‘within the ordinary meaning of that term’… This ordinary meaning was not intended to be affected by the operation of state or territory laws. However, real property has been interpreted to incorporate state and territory modifications to the concept.[47]

[41] Ibid, [585]-[589].
[42] Ibid, [597].
[43] Ibid, [603].
[44] Ibid, [619].
[45] Ibid, [599].
[46] Ibid, [600].
[47] Bill EM, [2.27].

Application to mining plant and equipment

Having rejected the Commissioner's primary submission on the meaning of 'real property' for Division 855 purposes, Colvin J then considered an alternative submission attempting to distinguish the reasoning of the High Court in *TEC Desert*. In that case, the Court held that mining plant and equipment located on land subject to a mining tenement was personal property (and therefore not dutiable under the relevant duty legislation).

In *TEC Desert*, the taxpayer did not own or lease the underlying land where the tenement was located, leading the Commissioner to argue that the High Court had not dealt with the characterisation of plant and equipment where, as in the present case (for some of the Newmont mines), the grantee of the mining tenement and the holder of the freehold or leasehold were the same party. The Commissioner argued that, in those circumstances, the plant and equipment formed part of the freehold or leasehold as general law fixtures and were TARP for Division 855 purposes.

Colvin J rejected this argument, describing *TEC Desert* as standing for the principle that "the status of the mining plant was determined by the status of the source of the authority to place the mining equipment on the land (and affix it), namely the mining tenements."[48]

In other words, it was the statutory authority granted under the relevant mining statutes which conferred a right to bring the mining equipment onto the land and to operate it, regardless of whether the land was also owned or leased by the grantee of the tenement. Per the High Court in *TEC Desert*, the mining tenements were personal property and imparted that character to the relevant plant and equipment. Moreover, his Honour found that, if the Commissioner's view was correct, there would be no logical basis to confine the merging of plant and equipment with the land to instances where the tenement and freehold were in common ownership. In other words, if the determinative factor is whether or not the plant and equipment were general law fixtures, they could potentially form part of the land regardless of the underlying ownership of the freehold. Such an outcome would be "entirely inconsistent with the scheme of the mining legislation" and would mean that mining plant and equipment could only be removed from the land through an analogy with the law of tenant's fixtures – this being the proposition that was expressly rejected by the High Court in *TEC Desert*.[49]

3.3.3 How broad is 'real property' now?

As will be clear from the text of the amendments, 'real property' as defined in the ITAA 1997 is proposed to be significantly broader than its technical, general law meaning and would, in our view, most likely capture the assets considered in *YTL Power* and *Newmont*, were those decisions to be decided under the new law.

Notably, the statutory definition in s 995-1(1) is an inclusive one, with the express limbs in the definition described in the Bill EM as building on the 'ordinary meaning' of real property.[50]

Given that Hespe J rejected outright that real property has an 'ordinary' meaning separate from its technical legal use, and that Colvin J rejected the breadth of the Commissioner's construction on this point, we think it is fair to say that uncertainty remains about the scope of the statutory concept more generally.

Some interpretive guidance on the express limbs of the definition of 'real property' is provided in the Bill EM, which we do not propose to set out here; although, as we note below, some of the interpretative guidance in the Bill EM is not squarely supported by the text of the proposed amendments.

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[48] *Newmont*, [641].
[49] Ibid, [650]-[652].
[50] Bill EM, [2.28].

It is also worth noting, as a preliminary matter, that there is known double-counting risk with the proposed formulation of the definition of ‘real property’. Take, for example, a wind turbine installed on land by an infrastructure operator under a licence from the landowner. Under proposed paragraph (d), the turbine (as a thing fixed or installed on land) will be 'real property'. Under proposed paragraph (c), the operator's licence to access the land on which the turbine is installed may also be 'real property', subject to the right of access being ‘incidental’ (as discussed further below). The result could be that the same underlying asset value – the wind turbine – may be counted as TARP for both the landowner (as a fixture forming part of the land) and the infrastructure operator (as a thing fixed or installed on land, or as a licence over such a thing under proposed paragraph (f)). Neither the Bill nor the Bill EM appears to provide a priority rule to resolve which entity's TARP calculation should include the asset's value.

A further – but unrelated – interpretive issue which informs the scope of Division 855 more generally arises from the amendments to the guide and objects provisions in Division 855. In particular, proposed s 855-1 and subsection 855-5(2)(b) refer to “real property or *closely related interests*” (see also, proposed subsection 855-30(1) of the ITAA 1997). The phrase 'closely related interests' is not defined anywhere in the Bill or the ITAA 1997, and the Bill EM describes it only as encompassing “interests, rights or arrangements that have a sufficient economic connection to real property, such that their value is principally derived from that property”. While these provisions are expressed as guide and objects material without direct operative effect, the introduction of an undefined and potentially expansive phrase into the statutory framework is unhelpful. Similar provisions have recently been read as informing the construction of operative provisions [51]– potentially extending the reach of the regime beyond what the substantive definition of 'real property' in proposed s 995-1(1) of the ITAA 1997 would otherwise support.

‘A licence or contractual right exercisable over or in relation to land’

This (very broadly expressed) limb of the definition has attracted the most criticism.

None of the terms used in the limb are defined for tax purposes. Based on ordinary statutory interpretation principles, therefore, each term should bear its natural and ordinary meaning, as informed by the context in which it appears and the legislative policy that is evident from that context.[52]

First to the text – the beginning and end of the statutory inquiry.[53]

According to the Encyclopaedic Australian Legal Dictionary, the term ‘licence’ and ‘contractual right’ bear the following natural and ordinary meaning:

> **Licence**: A permission to allow a person to do something on land, or to occupy land, on particular conditions, which may or may not include payment. Unlike a lease, a licence does not grant exclusive possession of the land. Licences fall into three categories: bare licence; licence coupled with a grant; and contractual licence (which may in some cases be irrevocable).[54]
>
> **Contractual right:** Rights arising out of a contractual relationship. Contractual rights may be express (that is, consciously agreed to by the parties to the contract, such as the right to demand performance of the promisor's specified obligations) or implied (usually by operation of law, such as the right to terminate the contract for the other party's breach of a condition), and can arise at common law, in equity, or under statute.

The prepositional phrase ‘in relation to’ usually connotes a connection of the broadest kind. In *Workers Compensation Board (Qld) v Technical Products Pty Ltd* (1988) 165 CLR 642, the Court noted that the

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[51] *Commissioner of Taxation v Hicks* [2025] FCAFC 171, [84]-[85].
[52] The High Court recently reaffirmed this principle in *Australian Securities and Investments Commission v King* (2020) 270 CLR 1; see also Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue (2009) 239 CLR 2.
[53] *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503, 519.
[54] See also, *Radaich v Smith* (1959) 101 CLR 209.

expression *'in respect of'* (and similarly *'in relation to'*) has a wide meaning, and "…gathers meaning from the context in which it appears and it is that context which will determine the matters to which it extends." However, in *Jeffrey James Prebble Pty Ltd v Federal Commissioner of Taxation (2003) ATC 4770*, Hill and Hely JJ observed at 4777, in the context of s 82AAA(i) of the ITAA 1936, as follows:

> We find little assistance from the numerous cases which have concerned the word "in relation to" for the meaning of the expression must be found from the context in which it appears. To say that the words require "a relationship between two subject matters" will usually be true. This, however, does not necessarily lead to the conclusion here that (the) taxpayer and employee must be two separate persons.

Similarly, in *Woodside Energy Ltd (ABN 63 005 482 986) v Commissioner of Taxation (No 2*) [2007] FCA 1961, French J stated that:

> …the words "in relation to" and similar terms such as "in respect of" or "in connection with" or just "in" have been considered in many cases and many contexts. All of them indicate a necessary connection between two subject matters which may be activities, events, persons or things. The nature and closeness or remoteness of the connection sufficient to answer the statutory description depends upon its context. The term "in respect of" was said to "[gather] meaning from the context in which it appears …": Workers' Compensation Board (Qld) v Technical Products Pty Ltd (1988) 165 CLR 642 at 653–4 per Deane, Dawson and Toohey JJ. The term "in relation to" has been called a "prepositional phrase" which is "indefinite" and which "subject to any contrary indication derived from its context or drafting history … requires no more than a relationship whether direct or indirect between two subject matters": O'Grady v Northern Queensland Co Ltd (1990) 169 CLR 356 at 376 (McHugh J). As the present case illustrates the extent of the relationship required depends upon the context in which the words are used... Context and purpose are everything in the construction of such indefinite phrases as "in relation to".

The words 'in relation to' as proposed in paragraph (c) are themselves unlikely to be interpreted narrowly by a court. The key question would then be whether any connection between, say, a contractual right and land would be sufficient to satisfy the nexus test in this paragraph. In the absence of specific textual guidance, the answer to that question is likely to be informed by the broader context, structure and policy of Division 855, and its role within the ITAA 1997.

As discussed above, the broader policy underpinning the changes introduced by the Bill is a desire by the Government to treat assets 'with a close economic connection to Australian land and natural resources' as subject to tax under the foreign resident CGT rules.

This policy objective finds support in the explanatory materials addressing paragraph (c). In particular, according to the Bill EM, the limb is intended to capture land-related licences and contractual rights that are neither estates nor fixtures at general law but whose 'value is inseparable from Australian land and natural resources.'[55] This limb, according to the Bill EM, would include forestry or agricultural licences, infrastructure operating and maintenance licences, and contractual rights such as in respect of toll roads, bridges, carparks, ports, data centres and energy infrastructure including pipelines.

Importantly, however, this limb is **not** intended to capture an entity's licence or contract to access premises to perform services where the right of access is "*merely incidental*" – for example, hotel cleaning contracts.

The Bill EM includes an example (see Example 2.1) of an IT services company that enters into a contract with a data centre owner, providing rights for the services company to occupy parts of the building to house its servers and for personnel to access the building to maintain and operate the servers. The example concludes that the overall arrangement would fall within this limb of the definition, although the second right, if divorced from the first, would not, on the basis that the right to operate and maintain the servers is said to be 'incidental to the first right'.

[55] Bill EM, [2.42].

The 'merely incidental' carve-out contained in the Bill EM does **not** appear within the text of the amendments but would seem to have substantive work to do in the proper interpretation of this limb, as informed by the context set out in the Bill EM. It is unfortunate that the legislature was not minded to expressly qualify paragraph (c) with this limitation rather than obliquely referencing it in the explanatory materials.

So, where does that leave us?

On one view, it would seem that, at the very least, for a licence or contractual right to fall within paragraph (c), it must have a 'close economic connection' to land in more than a merely incidental way. Put another way, the rights must derive a significant source of their value from a physical connection to Australian land or natural resources, rather than the connection to land being merely incidental to the exercise of those rights. On this view, for example, rights under customer contracts which are performed at a specific location (e.g. an office building in the Sydney CBD), and any goodwill inhering in those contracts, should clearly not be 'real property'. Similarly, rights under a cleaning contract at a mine site should not be 'real property'. In each case, the clearly better view is that these rights would typically not derive a significant source of their value from a connection to the land or the mine site, as the case may be – rather, the value, it would be argued, would be derived from the services performed under those contracts, notwithstanding that those services may be performed from a particular location or site.

Leaving aside obvious questions of valuation – which, if the above interpretation is correct, would inform the scope of this limb – the fundamental difficulty with the limb is that in many cases the source of value in respect of a contractual right will not be exclusively referable to either the right itself or the underlying land, but will instead be attributable in part to each. Neither the legislation nor the explanatory materials which support it provide a principled basis on which to determine the point at which the connection to land ceases to be 'merely incidental' and becomes sufficiently proximate to fall within the definition.

'A thing (or combination of things) that is fixed or installed on land'

This limb is intended to capture all things fixed or installed on land, regardless of whether they are characterised as fixtures at general law, and disregarding the impact of severance or other State or Territory legislation, including mining legislation, which has the legal effect of divorcing rights with respect to physical assets from rights to the underlying land.

So, for example, wind farm assets brought onto leased land by a tenant wind farm company are now expected to fall within the definition of 'real property'. This is so despite the Court of Appeal of the Supreme Court of Victoria finding that wind farm assets were chattels, not fixtures, under the common law doctrine of fixtures.[56] Moreover, in that case, even if the wind farm assets were fixtures at common law, the court found that the effect of s 154A of the *Property Law Act 1958* (Vic) was to exclude them from the hypothetical fee simple estate to be valued. In other words, the court found that the effect of s 154A was that the assets did not form part of the tenant's land and were therefore not to be taken into account in assessing its capital improved value.

Under proposed paragraph (d), the fact that the wind farm assets in that case were found to be chattels, and otherwise severed under statute from the tenant's land, would be disregarded; the mere fact of their fixation or installation on land would be sufficient to bring them within the scope of the paragraph.

The policy intention is to capture equipment that is 'useful when fixed or installed on land' in Australia and is stated to capture utilities infrastructure, transmission lines, large-scale energy storage systems and heavy machinery. The 'combination of things' aspect of the limb is expressed to ensure that items which are attached to each other and fixed or installed to the land would be captured, for example, large-scale infrastructure comprised of many separate interdependent component assets, even if only some of them are fixed or installed

[56] *Valuer-General v AWF Prop Co 2 Pty Ltd* [2021] VSCA 274.

on land. However, this is expected to exclude 'co-located' things (for example, desks, chairs, laptops and workstation equipment) as these items "can be removed from the land without affecting the land or the substantive use value of the land."

3.4 Key proposed changes: 'principal asset test'

Under the proposed changes, the PAT will be amended from a point-in-time test (assessed just before the relevant CGT event happens) to a 365-day look-back test. Based on this revised approach, consideration will need to be given to whether the aggregate market value of a test entity's TARP assets (held directly or indirectly) exceeded its non-TARP assets at *any* point during a 365-day period ending just before the relevant CGT event. This is introduced by the amendment to proposed paragraph 855-25(1)(b) of the ITAA 1997.

According to the Bill EM, this change is intended to align with the OECD Model Tax Convention and aims to prevent manipulation of asset values around transaction dates:[57]

> *2.58 This integrity measure reduces the ability of foreign entities to manipulate the asset composition of the interest in anticipation of a sale to avoid passing the PAT at the point of sale.*
>
> *2.59 This approach bolsters the integrity of the provision and aligns with the current OECD Model Tax Convention and the OECD Multilateral Instrument.*

The Bill EM does not address the existing integrity rules in ss 855-30(5) and 855-32, which (i) require the market value of any asset acquired by the test entity to be disregarded where the acquisition was undertaken for a non-incidental purpose that included ensuring that the PAT would not be satisfied; and (ii) prevent the duplication of non-TARP assets under the PAT. Nor does it acknowledge the alternative scenario in which TARP assets disposed to satisfy the PAT at the time of sale would generally be expected to be subject to Australian tax in any event. Given that these existing provisions are specifically designed to address the concerns about manipulation cited in support of the proposed change, it is not entirely clear why the introduction of a 365-day look-back test is considered necessary.

Changing the PAT from a point-in-time test to a 365-day look-back test is, in our view, likely to create a significant additional compliance burden for taxpayers. In principle, proposed paragraph 855-25(1)(b) of the ITAA 1997 requires the market value of all assets of the underlying entity – and all relevant lower-tier entities – to be determined at each point in time during the relevant 365-day period. Where an asset's market value fluctuates materially over time – including mining assets subject to commodity price movements, agricultural assets subject to seasonal variation, and renewable energy assets subject to regulatory and market changes – applying the new test will be a practically onerous exercise and is likely to result in significant compliance costs; a notion which seems to be somewhat lost on Treasury: [58]

> *The provision operates on a look-back basis from the date of the CGT event and* ***is not intended to operate in a manner that would require overly burdensome compliance approaches leading up to a CGT event.***
>
> *These amendments do not alter the understanding or application of market value calculation by foreign investors. For example, prior to the amendments, foreign residents, in determining the market value of each underlying asset, would need to consider the nature of the transaction, the nature of the underlying assets, the underlying assets within the sale (and their relationships with each other), any synergies between the assets that may influence the market value of each underlying asset of the sale and the relevant business operations of the taxpayer.* ***The transition to the 365-day testing period does not alter these considerations.***

[57] Bill EM, [2.58]
[58] Bill EM, [2.59]-[2.60].

The compliance burden will be particularly felt by minority investors who will generally not have ready access to information necessary to assess the market value of the underlying entity's assets on each day during the preceding 365-day period.

The Bill EM refers to the Minister having the power to determine by legislative instrument the circumstances in which a specified alternative testing time applies – a power which may accommodate foreign residents who do not control or influence the underlying entity and instead rely on publicly available information such as quarterly reports. However, compliance with the 365-day testing period will apply as the default, and no such instrument has yet been made.[59] Until such an instrument is made, the compliance burden falls in full on all foreign residents within scope, regardless of their ability to access the information necessary to apply the test.

As a practical matter, as mentioned above, the tax outcomes may be inappropriate where an entity has, prior to a sale of the shares in the entity, disposed of TARP assets (and paid Australian tax on the disposal). Take the following example:

- Company A disposes of its TARP assets during the new PAT 365-day window.
- Company A pays Australian capital gains tax on the disposal of the assets, at a rate of 30%.
- Company A then reinvests the proceeds in non-TARP assets, or otherwise retains the proceeds from the sale as cash.
- Shortly after the disposal of the TARP assets, a foreign resident shareholder of Company A independently disposes of its shares in the company.

At the time of the foreign resident's disposal, Company A’s assets are principally non-TARP, and the PAT would not be satisfied on a point-in-time basis. However, under the 365-day look-back, the PAT may be satisfied because the TARP assets were held at an earlier point in the window. This gives rise to a risk of economic double taxation on the same underlying asset value: the TARP assets are taxed once on disposal by Company A, and again (indirectly) on disposal of the membership interest by the foreign resident. This outcome is particularly stark when contrasted with the current tax settings under which the prior disposal of the TARP assets would cause Company A to cease being 'land-rich' for tax purposes altogether – that is, the company would no longer have assets principally comprising TARP, and the PAT would simply not be satisfied.

There is, however, a related interaction between the application of the new PAT and the availability of certain CGT roll-overs. To continue the example above:

- Shortly after the disposal of the TARP assets, Company A acquires all the shares in Company B.
- Immediately prior to the transaction, the shares in Company B are TAP.
- Shareholders in Company B exchange their Company B shares for Company A shares.

In the example above, under the current rules, a foreign shareholder in Company B would **not** be eligible for CGT roll-over as the replacement shares (i.e. the shares in Company A) are not TAP immediately after the acquisition.[60] However, under the new rules, for the purposes of testing whether the Company A shares are TAP, the foreign shareholder would be required to have regard to the market value of the TARP assets disposed of by Company A shortly before the acquisition, and therefore, may be taken to have acquired replacement interests which are TAP for the purposes of roll-over relief.

[59] Bill, sch 2, Items 16-17.
[60] ITAA 1997, s124-795(1).

The PAT will also be affected by proposed amendments to s 855-30 of the ITAA 1997 which will deem mining, quarrying or prospecting information (**MQPI**) to be TARP for the purposes of the PAT. Oddly, MQPI is expressly not characterised as TARP for direct disposal purposes, yet its value is counted on the TARP side of the PAT ledger for indirect disposal purposes. Other than noting this discrepancy, the Bill EM does not explain it further.

3.5 Key proposed changes: treaty override

The Bill contains a 'treaty override' clause which amends the *International Tax Agreements Act 1953* (Cth) (**ITAA 1953**), the Act incorporating Australia's tax treaties into domestic law. The amendments provide that where a reference to 'real property', 'immovable property' or 'land' in a treaty is taken to have its meaning under Australian law, it will be taken to mean TARP within the meaning of the ITAA 1997.[61] This amendment applies on and after the commencement day, and is therefore prospective only, which is consistent with the approach taken in the *Lamesa* amendments in 1999. Those amendments, enacted by the *Taxation Laws Amendment Act (No. 11) 1999* (Cth) in response to the Federal Court's decision in *Commissioner of Taxation v Lamesa Holdings BV* (1997) 77 FCR 597, introduced changes to the ITAA 1953 to, broadly, ensure that Australia could maintain its taxing rights over alienations of Australian real property in situations where the real property is owned by non-residents through a chain of interposed entities.

3.6 Key proposed changes: time-limited CGT discount for qualifying renewable assets

Renewable energy assets are one clear example of assets which are (at least in many cases) not real property at general law, and therefore not taxable Australian real property under current law, but which will be TARP under the proposed changes. From a policy perspective this puts the proposed changes in clear conflict with the broader push towards net zero and the intention to increase renewable energy generation in Australia.

In a bid to lessen the blow to the renewable energy sector, the Bill contains a time-limited 50% CGT discount for capital gains arising in relation to 'Australian renewable energy assets' or membership interests that pass the 'renewable energy asset test'.[62] The discount is only available to foreign residents who are not individuals. The discount is provided for in proposed Division 855 of the *Income Tax (Transitional Provisions) Act 1997* (Cth) (**ITTPA**).

An 'Australian renewable energy asset' is defined as a CGT asset that satisfies the following conditions (see, proposed s 855-10 of the ITTPA):

(a) the asset is taxable Australian real property;

(b) the primary purpose of the asset is either:

  (i) to generate or produce electricity in Australia using an eligible renewable energy source (within the meaning of the *Renewable Energy (Electricity) Act 2000*), whether the generation or production occurs presently or is to occur in the future; or

  (ii) to operate as an energy storage system for such electricity.[63]

[61] Bill, sch 2, Item 21.
[62] Bill, sch 3, Item 1.
[63] Ibid.

A membership interest passes the test if, at the time of the CGT event, the sum of the market values of the test entity's Australian renewable energy assets is equal to or greater than 3 times (that is, 75% of the total TARP asset value) the sum of the market values of its assets that are other kinds of TARP.

The inconsistency in approach between the testing time proposed under the PAT (described above) and the renewable energy concession is not explained in the Bill EM, despite acknowledgements that the concession is intended to 'operate alongside' the broader changes, and that '[t]he valuation approach used for the renewable energy asset test must be consistent with the valuation approach used in the principal asset test under Division 855…"[64]

The discount will only apply to CGT events occurring on or after the commencement day – being the first 1 January, 1 April, 1 July or 1 October to occur after the Bill receives Royal Assent – and before 1 July 2040.

The concession was initially limited to CGT events occurring before *1 July 2030* which would have presented significant challenges to incentivise new investment in renewable energy projects which typically have an operational life of 25 to 35 years.

While the Government's decision to accept industry submissions to extend the sunset date to 2040 is a welcome development, there is a strong argument that the concession should **not** be time limited at all – at least while the energy transition remains a central pillar of the Government's policy agenda.

3.7 Key proposed changes: foreign resident CGT withholding

The Bill includes changes to the foreign resident CGT withholding rules for transactions which, broadly, (when aggregated with 'related transactions') have a value of $50 million or more, and which involve a declaration that a CGT asset is a membership interest but not an IARPI (i.e. an Interests Declaration).

3.7.1 Existing rules

Broadly, under the current foreign resident CGT withholding regime in Subdivision 14-D of Schedule 1 to the TAA, a purchaser who acquires a CGT asset that is TARP or an IARPI (or an option or right to acquire TARP or an IARPI) by acquiring the asset from a 'relevant foreign resident' may be required to pay 15% of the consideration paid to acquire the asset to the Commissioner.[65]

Broadly, an entity is a 'relevant foreign resident' if the purchaser knows or reasonably believes the entity is a foreign resident, or the purchaser does not reasonably believe the entity is an Australian resident and either the entity has an address outside Australia or the purchaser is authorised to provide a related financial benefit to a place outside Australia. An entity will also be a 'relevant foreign resident' if it has a connection outside Australia of a kind specified in the regulations, or if the CGT asset to which the transaction relates is TARP or an IARPI the holding of which causes a company title interest (within the meaning of Part X of the ITAA 1936) to arise.[66]

However, an entity will **not** be a 'relevant foreign resident' where the entity:

- gives the purchaser a clearance certificate from the Commissioner, in respect of a CGT asset which is TARP or an IARPI which is a 'company title interest'; or

[64] Bill EM, [2.14] and [2.38].
[65] TAA sch 1, s 14-200.
[66] TAA sch 1, s 14-210(1).

- makes a declaration that the entity is an Australian resident for tax purposes (**Residency Declaration**) or that the CGT assets are membership interests that are not IARPIs (**Interests Declaration**), in respect of a CGT asset which is an IARPI.[67]

Currently, a purchaser will be entitled to rely on a Residency Declaration or Interests Declaration to alleviate their obligation to withhold under Subdivision 14-D unless they **know** the declaration to be false.[68] According to the Explanatory Memorandum introducing the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* (Cth), the purchaser's knowledge threshold is, under the existing law, intended to be a particularly high one (emphasis added):

> *2.83 A purchaser will only know a declaration to be false if they have specific knowledge of the fact. That is,* ***the purchaser must be a party to the fraud committed by the vendor or must have knowledge that the declaration is completely implausible. In all other circumstances, the declaration may be relied on. That a purchaser may have reasonable grounds to doubt the accuracy of a declaration does not, of itself, prevent the purchaser from relying on it.***

There are also specific exclusions for certain kinds of transactions, including transactions that take place on an approved stock exchange or conducted using a crossing system.[69]

3.7.2 Scope of changes

- The amendments generally do **not** apply to a declaration that an entity is an Australian tax resident i.e. a Residency Declaration, with the exception of the change to the purchaser's knowledge condition.

- The scope of these changes is otherwise limited to Interests Declarations. Treasury's initial consultation paper suggested that the measure would **not** apply to Interests Declarations where the non-portfolio interest test was not satisfied (emphasis added):[70]

  > The measure, as announced, **does not seek to alter the current legislation which applies to exclude certain transactions from the existing foreign resident capital gains withholding regime, such as** transactions on an approved stock exchange, or **the non-portfolio interest test which prevents membership interests of less than 10 per cent from being an IARPI.**

  Based on this initial proposal, therefore, only Interest Declarations made on the basis that the PAT was not satisfied would have been subject to the new regime. Ultimately, however, the changes proposed by the Bill (and the Exposure Draft) were not qualified on this basis, and no explanation is provided for why this broader approach was adopted.

- The changes will only apply to transactions where the first element of the purchaser's cost base in relation to the transaction 'and any related transactions that have been or are being undertaken' is $50 million or more. The meaning of 'related transaction' in this context is unclear. For example, does the concept extend to multiple contemporaneous disposals in respect of the same underlying entity by unrelated vendors to unrelated purchasers? What if the same purchaser undertakes a series of acquisitions over a period of weeks or months? The Bill EM states that this requirement is intended to prevent the artificial splitting of a single transaction into smaller transactions 'in order to circumvent the notification requirements."[71] On that

[67] TAA sch 1, ss 14-210(2)-(3), 14-220, 14-225.
[68] TAA sch 1, s 14-210(3)(b). However, note that, where the CGT asset is TARP or an IARPI, the holding of which causes a company title interest (within the meaning of Part X of the ITAA 1936) to arise, a Residency Declaration will not be effective: TAA sch 1, s 14-210(3)(c).
[69] TAA sch 1, s 14-215.
[70] Australian Treasury, 'Strengthening the foreign resident capital gains tax regime – Consultation paper' (July 2024), page 13.
[71] Bill EM, paragraph [2.75].

basis, a vendor that deliberately structures a sell down by disposing of parcels of shares of less than $50 million to avoid the ATO notification requirement, would be required to aggregate all of its sale interests. When read, and administered, with this context in mind the requirement may have more limited application in practice. Still, this aspect of the rules introduces uncertainty and will likely require some administrative guidance to confirm the ATO's expectations. In the absence of such guidance, well-advised purchasers would likely err on the side of caution and treat transactions on the border as falling within scope.

- More generally, the proposed expansion of the definition of TARP (as explained above) will have follow-on implications for the scope of the existing foreign resident CGT withholding regime. As a practical matter, the expanded definition is likely to result in a significant increase in the number of transactions in which vendors will be required to obtain and deliver a clearance certificate from the Commissioner to a prospective purchaser, given that neither an Interests Declaration nor a Residency Declaration by the vendor will alleviate the purchaser's withholding obligation in respect of acquisitions of TARP. For example, the grant of a licence, or an option or a right in respect of a licence, will now technically require a clearance certificate to be provided by the grantor of the licence to the grantee, even in cases of an arm's length licence on market terms which does not otherwise have any value.

3.7.3 Proposed changes

The diagram at section 3.7.4 below illustrates the new process.

The foreign resident CGT withholding rules will be amended such that, for transactions with an aggregate market value of AUD $50 million or more, a purchaser will not be entitled to rely on an Interests Declaration unless one of the following conditions is satisfied:

- the vendor has given the Commissioner a notice in the approved form in relation to the declaration within the required timeframe, and the purchaser is provided with a declaration in relation to the notice (see further below); or

- the transaction is of a kind specified by the Minister by legislative instrument under proposed paragraph 14-210(6)(b) of Schedule 1 to the TAA, or circumstances specified in such an instrument apply to the transaction. The Ministerial instrument carve-out is expected to accommodate transactions subject to court or administrative processes, such as schemes of arrangement or acquisitions under the merger control regime, where the notification timing requirements may be practically difficult to satisfy: see paragraph 2.92 of the Bill EM.[72] For public M&A transactions, market practice at present is that the bidder usually engages with the ATO to clarify the application of the withholding rules; subject to any Ministerial instrument carve-out for schemes of arrangement, under the proposed rules, this may now require more active involvement by the target to manage the notification process with the ATO on behalf of relevant target shareholders.

For transactions where the period between signing and completion (the 'review period', being the period from when the contract is entered into until immediately before the purchaser becomes the owner of the CGT asset) is:

- longer than 31 days, the notice must be provided to the Commissioner at least 28 days before the purchaser becomes the owner of the CGT asset; or

[72] Bill, sch 2, Items 22-37.

- shorter than 31 days, the notice must be provided to the Commissioner as soon as reasonably practicable after the transaction is entered into but before the purchaser becomes the owner of the CGT asset.

If the vendor fails to provide the notice to the Commissioner within the required timeframe, or fails to provide the purchaser with a declaration that it has given the Commissioner such notice (including the day on which the notice was given) (**a Notice Declaration**), the purchaser will be required to withhold under Subdivision 14-D.

A purchaser will not be entitled to rely on a Residency Declaration or an Interests Declaration if, at any time during the period starting when the declaration is given and ending immediately before the purchaser becomes the owner of the CGT asset, the purchaser knows, or could reasonably be expected to know, the declaration to be false[73]: see proposed s 14-210(3)(b) of Schedule 1 to the TAA. Relatedly, the Bill EM suggests that this new purchaser knowledge requirement will also apply to a Notice Declaration,[74] however, this reading does not seem to be supported textually on the basis that proposed s 14-210(3)(b) would **not** seem to extend to a Notice Declaration provided under s 14-225(2A).

The new purchaser knowledge requirement replaces the former subjective test (requiring actual knowledge that the declaration was false) with an objective or constructive knowledge standard.

The Bill EM suggests that what constitutes 'reasonable grounds' will depend on the facts and circumstances of the transaction, although it is expected that purchasers will need to undertake and document "proportionate, customary checks (such as reviewing ASIC and ABR extracts, transaction documents, and any residency disclosures), address obvious inconsistencies through routine queries, and retain records". [75]

This change will impose an additional – and in some cases, ongoing and onerous – due diligence obligation on purchasers, particularly in the context of transactions where complex valuation questions arise in connection with the application of the broadened PAT.

The Bill does not prescribe a process for the ATO to respond to notifications in relation to the making of declarations, but it would be expected (including based on the July 2024 consultation paper) that if the ATO had a concern about the correctness of a declaration it would notify the purchaser of that concern.

This is contemplated by the Bill EM:[76]

> Further, a purchaser may also have reasonable grounds to believe that the vendor's declaration is false if the purchaser has been notified by the Commissioner that the Commissioner believes there are grounds for applying withholding with respect to the transaction or the Commissioner reasonably believes the declaration may be false.

The practical likelihood of the ATO erring on the side of caution and recommending a withholding position under the proposed framework is probably higher. It is not clear whether any avenue will exist for a taxpayer to be able to persuade the ATO in these circumstances that the underlying entity is not land rich. The potential for the ATO and a taxpayer to disagree on such issues in the throes of a live transaction was illustrated in *Deputy Commissioner of Taxation v State Grid International Australia Development Company Limited* [2022] FCA 139.[77]

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[73] Ibid.
[74] See Bill EM, [2.86].
[75] [2.87].
[76] Bill EM, [2.89].
[77] In *State Grid*, the Commissioner sought urgent freezing orders on the eve of the implementation of a scheme of arrangement under which State Grid, a Hong Kong-incorporated subsidiary of a Chinese state-owned enterprise, was to dispose of its shareholding in AusNet Services Ltd. The Commissioner had determined that the shares constituted an IARPI, and therefore, subject to Australian CGT– a position which State Grid disputed. The Court granted the freezing orders, notwithstanding that the CGT liability had not yet been assessed.

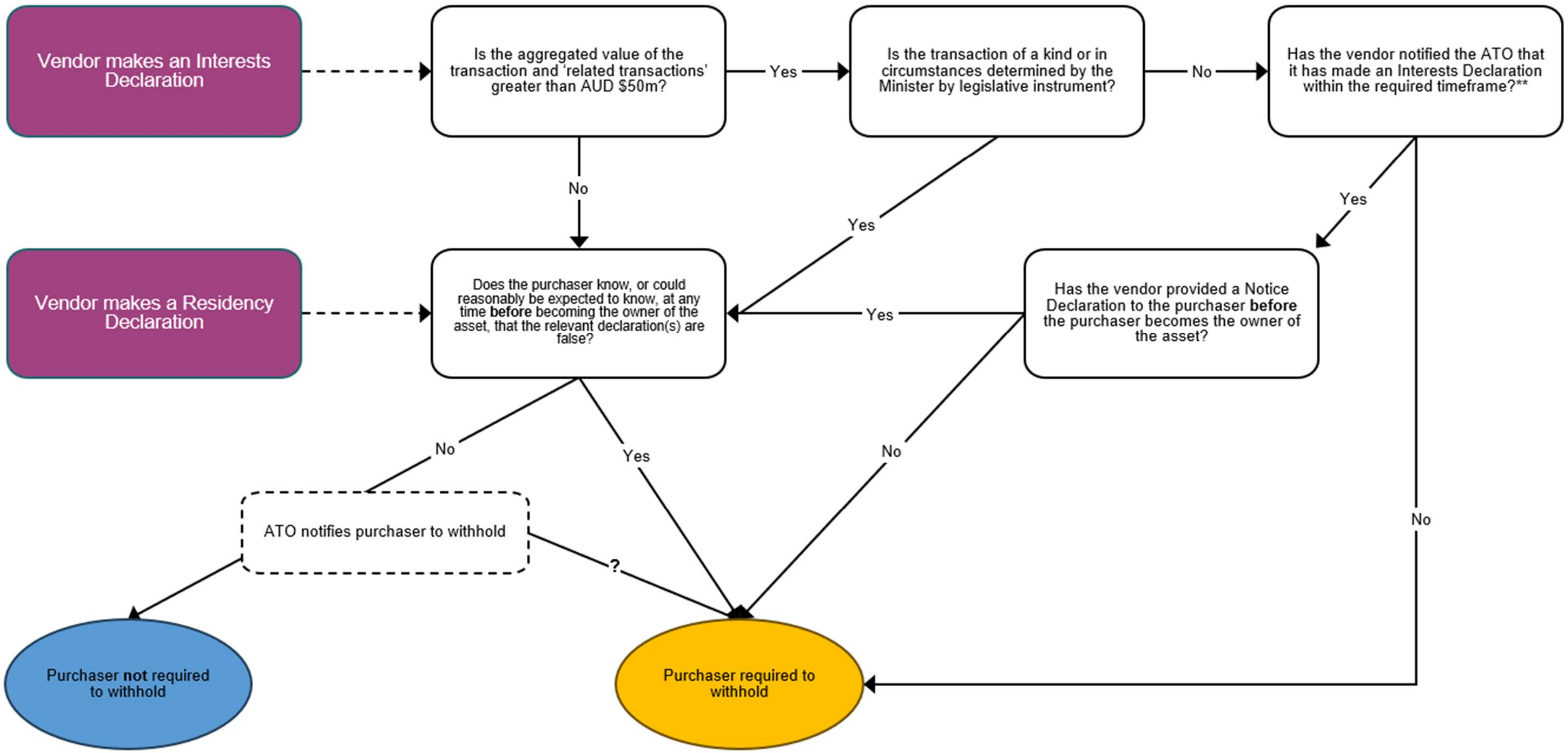
What is even less clear is whether, under the proposed framework, a notification by the ATO would, of itself, be expected to result in the purchaser being in a position where it could no longer rely on the vendor's declaration as a basis on which withholding was not required (although, it is difficult to envisage a scenario whereby a well-advised purchaser would not withhold based on an ATO recommendation).

Administrative penalties for making false or misleading statements will also be extended to declarations made in relation to foreign resident CGT withholding.[78]

For transactions with an aggregated market value of less than AUD $50 million, the existing rules will largely apply, although subject to the expanded knowledge test described above.

[78] Bill, sch 2, Items 30, 32, 34.

3.7.4 Flowchart: Proposed changes to the foreign resident CGT withholding rules



This flowchart does not address the acquisition of a CGT asset which is TARP or an IARPI the holding of which causes a company title interest (within the meaning of Part X of the ITAA 1936) to arise.

**At least 28 days before completion if the period between signing and completion is greater than 31 days, otherwise as soon as reasonably practicable after signing and before completion.*

4. Earnout arrangements

4.1 Introduction

It is common for prospective sellers and buyers to disagree on the underlying value of the assets of the target. One way to bridge that value gap is for the parties to adopt a purchase price mechanism which consists of an 'upfront payment' of cash or shares (or a combination of the two) and a 'deferred payment' of cash or shares or a combination. Unlike the upfront component, the payment of the deferred component of the purchase price is generally conditioned on the "achievement of financial or other performance targets [of the business] after the deal closes."' [79]

As a commercial matter, this type of arrangement is typically designed to allow the owners of the target to achieve the best possible price for what they perceive as a high performing business asset while addressing apparent 'information asymmetry' for prospective buyers who think that sellers are overvaluing their business.[80] It may also incentivise sellers who remain part of management after the transaction to continue to contribute to the financial performance of the business.

The deferred component of the purchase price is commonly referred to as an 'earnout arrangement'. An earnout arrangement may take the form of a 'standard earnout', whereby the seller is entitled to additional financial benefits as a component of the purchase price where those financial benefits are conditional on the performance of the business (as described above), or a 'reverse earnout', whereby the buyer is entitled to certain financial benefits as a return of a component of the purchase price where those financial benefits are conditional upon the *failure* to achieve certain performance targets.

For CGT purposes, the ATO has historically preferred the view that, under standard earnout arrangements, the seller of the business should be subject to tax on the basis that it has acquired a proprietary right that is separate and "independent of the sale transaction from which it arises",[81] and therefore, earnout payments made by the buyer would not be made in respect of the business assets but paid in discharge or satisfaction of that right.[82] This approach was originally outlined by the ATO in two separate tax rulings, each of which are now withdrawn (including the Draft Taxation Ruling, which has been withdrawn on two separate occasions). The ATO's 'separate asset' approach has been widely criticised as being "contrived'[83], "unfounded on both a

[79] Robert F. Bruner and Scott Stiegler, 'Technical Note on Structuring and Valuing Incentive Payments in M&A: Earnouts and Other Contingent Payments to the Seller' (Working Paper, Technical Note on Structuring and Valuing Incentive Payments in M&A: Earnouts and Other Contingent Payments to the Seller, 12 December 2000) 1. See also, Leonidas G. Barbopoulos, Krishna Paudyal and Sudi Sudarsanam, 'Earnout Deals: Method of Initial Payment and Acquirers' Gains' (2018) 24 *Journal of the European Financial Management Association* 792, 793.
[80] Ninon Kohers and James Ang, 'Earnouts in Mergers: Agreeing to Disagree and Agreeing to Stay' (2000) 73 *Journal of Business* 445, 445-446. See also Leonidas G. Barbopoulos, Krishna Paudyal and Sudi Sudarsanam, 'Earnout Deals: Method of Initial Payment and Acquirers' Gains' (2018) 24 *Journal of the European Financial Management Association* 793-794.
[81] Australian Taxation Office, *Income tax: capital gains: capital gains tax consequences of earnout arrangements* (TR 2007/D10, 17 October 2007) (**Draft Taxation Ruling**), [88].
[82] Ibid, [25].
[83] David Wood, 'M&A Transactions: What are the Issues? What are the Opportunities?' (Paper presented at National Convention, Brisbane, 2 March 2011) 3.2.

technical and policy basis"[84] and "fundamentally misguided",[85] and has led to a number of anomalous tax and commercial outcomes for taxpayers.

In May 2010, the Australian Treasury released a proposal paper for a legislative solution to the views expressed by the ATO.[86] Almost six years later, following extensive consultation, Treasury's proposal ultimately led to the introduction of a new 'look-through' earnout regime.[87] Under that regime, taxpayers are able to disregard a capital gain or loss relating to the creation of a 'look-through earnout right' and treat any financial benefit received or provided by the taxpayer as part of the sale (in 'capital proceeds') or acquisition (in 'cost base'), as the case may be, of the underlying business assets.[88]

The current legislative regime does offer a partial solution to the ATO's views in the Draft Taxation Ruling; indeed, not long after the legislative regime was introduced, the Draft Taxation Ruling was first withdrawn.[89] However, what is problematic is that the legislative regime only applies to certain qualifying 'look-through earnout rights'.[90]

According to a discussion paper published by the ATO in December 2018 (the **ATO Discussion Paper**),[91] the views expressed in the Draft Taxation Ruling were intended to apply to arrangements that did not qualify for 'look-through' treatment.[92] Around the same time, some of the anomalous tax and commercial outcomes arising for non-qualifying earnout arrangements had been canvassed by the Board of Taxation's self-initiated post-implementation review of Subdivision 118-I of the ITAA 1997 (the **Board of Tax Paper**).[93]

Since then, in November 2023, the ATO withdrew the Draft Taxation Ruling a second time.[94] There is a renewed lack of clarity, therefore, about whether (and how) the views expressed by the Commissioner in the draft ruling continue to apply to earnout arrangements which do not qualify for look-through treatment.

For some taxpayers, the effects of the separate asset approach may be ameliorated by the 'taxation of financial arrangements' (**TOFA**) rules contained in Division 230 of the ITAA 1997, although, as we explain below (and as seen in the recent decision in *Merchant*), the current legislative settings for the TOFA rules have made it challenging for those rules to apply to many earnout arrangements.

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[84] The Institute of Chartered Accountants in Australia, CPA Australia, the National Institute of Accountants, the Taxation Institute of Australia and Taxpayer Australia, Submission to Australian Taxation Office, *Draft Taxation Ruling TR 2007/D10 – Income Tax: capital gains: capital gains tax consequences of earnout arrangements*, 14 December 2007, 2 (**Joint Body Submission**).

[85] Chris Evans, 'Yearning for Earnout Certainty', (2008) 11 *Tax Specialist* 294, 297. See also, Grant Ellis and Tim Sherman, 'CGT Treatment of Earnout Arrangements' (Paper presented at Tax Institute of Australia Annual Tax Form, Sydney, 18 May 2010) 5.

[86] The Australian Treasury, *Capital gains tax treatment of earnout arrangements*, Proposals Paper (May 2010).

[87] *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* (Cth).

[88] ITAA 1997 ss 118-560(2), 118-565(1).

[89] Australian Taxation Office, TR 2007/D10W – Notice of Withdrawal: *Income tax: capital gains: capital gains tax consequences of earnout arrangements* (TR 2007/D10W, 7 December 2016).

[90] ITAA 1997 s 118-565(1).

[91] Australian Taxation Office, 'Issues concerning earnout arrangements (excluding arrangements that create look-through earnout rights)' (Discussion Paper, 3 December 2018) (**ATO Discussion Paper**).

[92] Ibid, [7].

[93] Australian Government Board of Taxation, 'Review of the Income Tax Treatment of Certain Forms of Deferred Consideration: a post-implementation review of subdivision 118-I of the Income Tax Assessment Act 1997' (September 2018) (**Board of Tax Paper**).

[94] Australian Taxation Office, TR 2007/D10W2 - Notice of Withdrawal *Income tax: capital gains: capital gains tax consequences of earnout arrangements* (TR 2007/D10W2, 15 November 2023).

4.2 The ATO's views on earnout arrangements

4.2.1 Draft Taxation Ruling

The Draft Taxation Ruling sets out the ATO's views on the tax consequences of 'standard' and 'reverse' earnout arrangements. A standard earnout arrangement is described in the ruling as a transaction involving the sale of an income producing asset that includes the creation of an 'earnout right',[95] which, according to the ruling, is a "right to an amount calculated by reference to the earnings generated by the asset for a defined period following the sale (generally a period of between one and five years)",[96] and which is to be distinguished from a right to an amount of money which is certain.[97]

In the Draft Taxation Ruling, the Commissioner tries to achieve symmetry in the tax consequences for the seller and the buyer:

	Tax on grant of the right	Tax on further payments
Seller[98]	Capital proceeds for disposal of asset includes upfront consideration **and** the market value of the earnout right at the time of the CGT event[99]	Payment of an amount in satisfaction of the earnout right causes CGT event C2 to occur – the time of the event is when the right ends[100]
Buyer[101]	Cost base for acquisition of asset includes upfront consideration **and** market value of the earnout right No CGT event D1 (involving the creation of contractual or other rights) occurs because the buyer is considered to be 'borrowing money' or 'obtaining credit' from the seller in creating the earnout right[102]	Cost base of the underlying business asset unaffected because any payment made under the earnout right is independent of the obligation to pay the purchase price for the asset

95 Draft Taxation Ruling, [2].
96 Ibid, [3].
97 Ibid.
98 Draft Taxation Ruling, [12]-[17].
99 The ATO considers that an earnout right is not an entitlement to money under s 116- 20(1)(a), but rather 'other property', the market value of which should be included in capital proceeds under s 116-20(1)(b). The ATO considers that it is not possible to 'look-through' the earnout right and treat payments in respect of the right as capital proceeds in respect of the disposal of the underlying business asset. The ATO's views in this regard are premised on the following key principles:

1. for 'money' to be included in capital proceeds under s 116- 20(1)(a) it must be 'known or ascertainable', and while this may include fixed amounts which the seller is entitled to receive at a later time, it does not include payments under an earnout right as there always exists the possibility that no payment will ever be received by the seller;
2. the 'earnout right' is a financial arrangement that is independent of the sale transaction (notwithstanding its origins are in the sale transaction), and deferred payments are not, in substance, made in respect of the acquisition of the assets but rather in respect of a separate obligation that is triggered depending upon the economic performance of the asset (citing *Marren* and *Zim Properties Ltd v Proctor (Inspector of Taxes)* (1984) 58 TC 371 as supporting that view);
3. the 'earnout right' is a proprietary chose in action, and capable of assignment; and
4. CGT event C2 will occur upon a discharge or satisfaction by payment of an amount in respect of the earnout right, or by the right expiring, and the CGT consequences arising from that event are dependent upon whether the right is treated as a single CGT asset or multiple CGT assets.

100 ITAA 1997 s 104-25(1).
101 Draft Taxation Ruling, [24]-[26].
102 ITAA 1997 s 104-35(5)(a).

Unlike the view taken in an earlier ruling (Taxation Ruling TR 93/15W), the ATO rules that by creating an earnout right in the seller, the buyer also ‘gives’ property, and therefore, the cost base of the underlying business assets it acquires will include the market value of the earnout right at the time the seller acquires that right.[103]

This was consistent with the Commissioner’s views in TR 2008/5,[104] where he expressed the view that when a company issues shares as consideration for assets, the provision of shares is the provision of property given, or required to be given, in respect of acquiring the assets.[105] According to the Commissioner, this was on the basis that, the more correct view is that the issuing of shares is the ‘giving of property’ for the purposes of the CGT cost base rules.[106] The Commissioner confirmed that the contrary view expressed in TR 93/15W – that in order for property to be ‘given’ for the purposes of working out the cost base for CGT purposes, that property first had to be the property of the giver – was withdrawn.[107]

The ATO takes the view that an obligation to make a payment under an earnout right is not a ‘requirement to pay’ money for the purposes of the first element of cost base, as there always exists the possibility that no payment will ever be made by the buyer.[108]

4.2.2 Some anomalies produced by the ATO’s position

The ATO’s views set out in the Draft Taxation Ruling produce a number of anomalous tax and commercial outcomes, some of which we discuss below.

- **Arguably no true gain.** As a commercial matter, the seller would be subject to tax on the market value of the ‘earnout right’ without arguably realising any economic gain at the time tax is imposed because the right to receive any financial benefit in respect of the right remains contingent upon events which, in most cases, are outside the seller's control (depending on the nature of the arrangement, for example, in a share for share exchange, it may require the seller to pay an unfunded tax liability).

- **Non-availability of CGT concessions or exemptions.** The seller may not be able to apply certain CGT concessions or exemptions available for the disposal of the underlying business assets to a gain made as a result of the creation of the earnout right or the subsequent payments made under it, for example:

    - the CGT discount would not apply to payments under the earnout right, unless those payments were received more than 12 months after the creation of the right;[109]

    - CGT scrip for scrip roll-over relief would not be available to the extent the seller’s capital proceeds comprise the market value of the earnout right on the basis that the earnout right would be ‘ineligible proceeds’;[110] and

[103] Draft Taxation Ruling, [24]-[25].
[104] Australian Taxation Office, *Income Tax: tax consequences for a company of issuing shares for assets or for services* (TR 2008/5, 27 August 2008) (**TR 2008/5**).
[105] Ibid, [11].
[106] Ibid, [81].
[107] Ibid.
[108] Draft Taxation Ruling, [130]. See also, *Dingwall v Federal Commissioner of Taxation* (1995) ALR 297.
[109] ITAA 1997 subdiv 115-A.
[110] See, e.g., ITAA 1997 subdiv 124-M. See in particular, ITAA 1997 s 124-790. See also, Australian Taxation Office, *Income Tax: Capital Gains tax: Partial scrip for scrip roll-over: ineligible* proceeds (ATO ID 2002/100, 10 December 2001).

    - the earnout right would not be a pre-CGT asset even if the underlying business asset was a pre-CGT asset.[111]

- **Potential double tax for seller.** If the receipt of the additional earnout payments by the seller is treated as ordinary income, the seller may be subject to double tax under the arrangement equal to the market value of the earnout right initially included in capital proceeds (the Draft Taxation Ruling did not consider whether such payments may constitute ordinary income,[112] but this issue is considered in the ATO Discussion Paper and the Board of Tax Paper). By way of example, if the market value of the earnout right at the time of creation is $60 and a subsequent earnout payment (treated as ordinary income) is $90, the seller's tax position may be as follows:

    - **Creation of earnout:** $60 capital proceeds for the disposal of the asset (being the market value of the right at the time of the CGT event); and

    - **Subsequent payment**: $90 ordinary (assessable) income. A CGT event C2 would occur on the discharge of the earnout right with the capital gain ($30, being $90 capital proceeds and $60 cost base) being reduced to nil by the anti-overlap rule.[113]

    Based on the above, the seller would recognise $150 ($60 + $90) for tax purposes but would make an economic gain of only $90. Put another way, the seller would effectively be subject to tax twice on the value of the earnout right.

- **Tax recognition for subsequent earnout payments.** The buyer would be unable to include any subsequent payments made under the earnout right in the cost base of the underlying business assets, but *may* be entitled to an immediate tax deduction,[114] or a deduction over five years as blackhole expenditure.[115] The tax recognition of subsequent earnout payments by the buyer is complicated and highly fact specific. The ATO has, for example, issued a number of (non-binding) private rulings indicating that subsequent payments in excess of the market value of the earnout right should **not** be deductible under s 40-880 of the ITAA 1997 as blackhole expenditure.[116]

- **Expiry of earnout right.** If the earnout right expires without any payment being made, or where the payments are less than the initial market value of the right:

    - the seller would be unable to offset any capital loss made as a consequence of the 'earnout right' expiring against any capital gain made on the disposal of its underlying business assets (subject to any capital loss 'carry back' entitlement)[117]; and

    - the buyer would not be required to reduce the cost base of its underlying business assets.[118]

[111] ITAA 1997 s 149-10.
[112] Draft Taxation Ruling, [10].
[113] ITAA 1997 s 118-20.
[114] ITAA 1997 s 8-1. See, e.g., *Cliffs International Inc v Federal Commissioner of Taxation* (1979) 79 ATC 4059 (***Cliffs International***).
[115] ITAA 1997 s 40-880. See also, Joint Body Submission, 5.
[116] See PBR authorisation number 94105 and 93599.
[117] Cf *Taxation of Chargeable Gains Act 1992* (UK) s 279A; Chris Evans, 'Yearning for Earnout Certainty', (2008) 11 Tax Specialist 294, 304. See also, Cindy Chan, 'Earnouts and CGT: fine-tuning the "look-through" approach' (2014) 18(1) *The Tax Specialist* 27, 27.
[118] Ibid.

4.3 Look-Through Earnout Rights

4.3.1 Background

On 12 May 2010, the Government announced that it would introduce a new regime to apply 'look-through treatment' to qualifying earnout arrangements.[119] At the same time, it released a consultation paper setting out the design of its proposal.[120]

Following a change in Government, and an extended period in which a number of announced but unenacted tax measures were held in abeyance, on 14 December 2013, the Government confirmed that it would proceed with the proposal to introduce a new legislative regime for 'look-through treatment' for qualifying earnout arrangements.[121]

Almost two years later, on 3 December 2015, the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* was introduced into parliament and finally passed by both houses on 22 February 2016 as the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016*, with royal assent provided on 25 February 2016.

4.3.2 The current legislative regime

Broadly, under the look-through earnout regime, taxpayers with qualifying earnout arrangements are entitled to ignore any capital gain or loss arising in respect of a 'look-through earnout right' and instead treat financial benefits received or paid in respect of such a right as part of the capital proceeds or cost base of the underlying business assets to which the arrangement relates.[122]

A new Subdivision 118-I was introduced into the ITAA 1997. The definition of a 'look-through earnout right' is contained in s 118-565 and is as follows:

> (1) A ***look-through earnout right*** is a right for which the following conditions are met:
>
> (a) the right is a right to future *financial benefits that are not reasonably ascertainable at the time the right is created;
>
> (b) the right is created under an *arrangement that involves the *disposal of a *CGT asset;
>
> (c) the disposal causes *CGT event A1 to happen;
>
> (d) just before the CGT event, the CGT asset was an *active asset of the entity who disposed of the asset;
>
> Note: For extra ways to be an active asset, see section 118-570.
>
> (e) all of the financial benefits that can be provided under the right are to be provided over a period ending no later than 5 years after the end of the income year in which the CGT event happens;
>
> (f) those financial benefits are contingent on the economic performance of:

[119] Assistant Treasurer Nick Sherry, 'Look-Through Treatment For Earnout Arrangements To Simplify Sale Of Business Assets' (Press Release, No 98, 12 May 2010).
[120] The Australian Treasury, 'Capital gains tax treatment of earnout arrangements' (Proposals Paper, May 2010).
[121] Assistant Treasurer Arthur Sinodinos, 'Integrity restored to Australia's taxation system' (Media Release, 14 December 2013).
[122] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015*, [1.21]-[1.23].

(i) the CGT asset; or

(ii) a business for which it is reasonably expected that the CGT asset will be an active asset for the period to which those financial benefits relate;

(g) the value of those financial benefits reasonably relates to that economic performance;

(h) the parties to the arrangement deal with each other at *arm's length in making the arrangement.

There are a number of ancillary provisions which were also introduced. For example, s 118-565(2) contains certain integrity rules which affect the maximum five-year period, and s 118-570 lists extra ways in which a CGT asset can be an active asset. The purpose of extending the active asset test definition beyond that contained in s 152-40 of the ITAA 1997 (in broad terms, an asset that is used or held ready for use in the course of carrying on a business) is two-fold: first, to allow interests in foreign entities to be active assets, and second, for the active asset test to be satisfied by reference to an income-based test rather than based on the underlying value of business assets (given the difficulty with valuing business assets in this context).[123]

The key operative provisions of this legislative regime, though, are contained in ss 112-36 and 116-120. Those provisions have the effect that the value of any look-through earnout right is ignored in the capital proceeds and cost base of a CGT asset, but that the amount of the financial benefit provided under the earnout right is included in those capital proceeds and cost base. There are also machinery provisions that operate to extend the amendment period for financial benefits provided under such arrangements.[124]

Look-through earnout rights and CGT roll-over

Under the 'look-through' earnout rules, taxpayers are entitled to 'remake' a choice under the CGT regime in relation to the relevant CGT event.[125]

The ATO has previously accepted that where a choice to apply roll-over has been made by a taxpayer at the time of the original CGT event, any shares acquired as part of the financial benefits received under a look-through earnout right would qualify for scrip-for-scrip roll-over under Subdivision 124-M of the ITAA 1997.[126] Based on this reasoning, the taxpayer would not need to rely on the provisions to 'remake' a choice because the original choice would be sufficient to apply to shares issued under the earnout arrangement.

It is possible, however, that a taxpayer is unable to elect to apply roll-over relief at the time of the original disposal because it does not satisfy the relevant preconditions for relief – for example, in a scrip-for-scrip roll-over context, the upfront consideration may only consist of cash. In these circumstances, the taxpayer may be able to 'remake' a choice to apply roll-over relief where the receipt of the deferred consideration means that the roll-over conditions are satisfied (e.g. the deferred consideration consists of eligible replacement interests, for example, shares in the buyer). Although there do not appear to be any ATO examples confirming this approach, it seems to be supported by the explanatory materials which state that, "in some cases, a taxpayer may not initially be in a position to elect that a concession to apply to a CGT event…. In these cases, as the taxpayer can remake choices they can simply wait until it is clear whether or not they will be finally eligible for the concession before making any choice."[127]

[123] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015*, [1.40] and [1.43].
[124] ITAA 1997 ss 112-36(3), 116-120(3).
[125] ITAA 1997 ss 112-36(2), 116-120(2).
[126] See PBR 1052214930033.
[127] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* (Cth), [1.108].

4.3.3 Arrangements that do not qualify for 'look-through' treatment

There are a number of reasons an earnout arrangement may not qualify for look-through treatment under the existing regime.

Reasonably ascertainable

For a right to be a 'look-through' earnout right, the financial benefits must not be reasonably ascertainable at the time the right is created. According to the Explanatory Memorandum introducing the regime, a contingency attached to the payment of a financial benefit will usually mean that it is also not reasonably ascertainable.[128] However, where there is little or no doubt that the contingency will transpire and the right relates to a payment that is fixed or can reasonably be determined, the right cannot be a look-through earnout right.[129] This may be illustrated by the following example.

In 2019, Cobalt 27 Capital Corp. (a Canadian listed company) acquired all the shares in Highlands Pacific Limited (ASX:HIG) (**Highlands**) in exchange for the payment of (a) cash consideration of $0.105 per share, and (b) additional cash consideration of $0.010 per share which would become payable if, before 31 December 2019, the closing spot price of nickel exceeded US$13,200 per tonne for a period of five consecutive trading days.[130] An independent expert valued the right to receive the additional consideration at $0.010 per share, "by applying a probability factor to approximate the likelihood of its payment", which was assessed by the independent expert to be between 90%-100%.[131]

Based on the expert's assessment, it would have been difficult to argue that the right to receive the additional cash consideration was not 'reasonably ascertainable.'

As expected, according to the Tax Disclosure in the Scheme Booklet, Highlands shareholders were advised to include in their capital proceeds $0.115 per share, comprising the initial lump sum cash consideration and the market value of the right to receive the additional cash consideration.[132] Hypothetically, if, despite the optimism expressed by the independent expert, the spot price for nickel did not reach the agreed level:

- shareholders may be subject to tax on the market value of the earnout right in the income year ended 30 June 2019 (equal to the $0.010 per share); and
- shareholders would make a capital loss (equal to the same amount, being the cost base of the right to receive the additional cash consideration) in the income year ended 30 June 2020, the income year in which the right expired.

CGT event A1

For a right to qualify as a look-through earnout right, it must be created under an arrangement that involves the 'disposal' of a CGT asset, and that disposal must cause CGT event A1 to occur.[133] The term 'disposal' is defined in s 995-1(1) by reference to the definition in CGT event A1.[134] According to the Explanatory

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[128] Ibid, [1.63].
[129] Ibid.
[130] Highlands Pacific Limited, *Scheme Booklet for Proposed Acquisition by Cobalt 27* (12 March 2019) Australian Securities Exchange <https://www.asx.com.au/asxpdf/20190312/pdf/443dv1cxrhjjqh.pdf>.
[131] Ibid, pp. 12, 95.
[132] See section 7.2 of the Tax Disclosure.
[133] ITAA 1997 s 118-565(1)(b)-(c).
[134] ITAA 1997 s 104-10.

Memorandum, CGT event A1 does not need to be the most specific CGT event that occurs,[135] but still needs to occur in addition to the other event.[136]

CGT event A1 does not always occur in mergers and acquisitions of businesses, particularly when such transactions occur under foreign law.

For example, in 2012, Xstrata and Glencore International plc announced a merger under which Glencore acquired all of the issued capital of Xstrata.[137] The merger was effected under a court approved scheme of arrangement under Part 26 of the *Companies Act 2006* (UK). Under the merger, the share capital in the target (Xstrata) was cancelled, and in exchange for each share held by a target shareholder, the shareholder was issued 3.05 Glencore shares.[138] The Commissioner ruled that for an Australian resident target shareholder, CGT event C2 occurred when their shares were cancelled, but that the shareholder may be eligible to choose scrip for scrip roll-over relief under Subdivision 124-M of the 1997 Act.[139] CGT event A1 however did not occur.

If, for example, the target shareholders were also conferred a right to receive one additional Glencore share in the event Xstrata met certain performance measures post-implementation, the right to receive that additional share would not be a 'look-through earnout right' because it would not be created under an arrangement that involves a 'disposal' of the share under CGT event A1, but rather, a 'cancellation' under CGT event C2.[140] In those circumstances, the right to receive the additional share would be 'ineligible proceeds' for the purposes of scrip for scrip roll-over and the market value of the right would be included in capital proceeds from the disposal and potentially subject to tax.[141] If that additional consideration were paid (or, more accurately, issued), the shareholder would be subject to tax based on the difference between the cost base of the right and the value of the additional share.[142]

There are other examples where an acquisition of business assets involves a cancellation of the ownership interests in the target entity owning the assets, which causes CGT event C2 rather than CGT event A1 to occur.[143]

Maximum five-year term

For a right to qualify as a 'look-through earnout right', all of the financial benefits that can be provided under the right must be provided over a period ending no later than five years after the end of the income year in which the CGT event occurs.[144] Given that most earnout arrangements are typically structured for between two to five

[135] ITAA 1997 s 102-25.
[136] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth) [1.30].
[137] Glencore International plc, *New Scheme Circular relating to the final terms of the recommended all-share merger of equals of Glencore International plc and Xstrata plc to be effected by means of a Scheme of Arrangement under Part 26 of the Companies Act 2006* (25 October 2012) Glencore International plc <https://www.glencore.com/dam/jcr:9c6625bc-0e8d-4574-85a9-935876c3f43e/New-Scheme-Circular-final.pdf>.
[138] Ibid, p. 12.
[139] Australian Taxation Office, *Income tax: scrip for scrip: exchange of shares in Xstrata plc for shares in Glencore International plc*, CR 2013/47, 19 June 2013, [34] and [46].
[140] ITAA 1997 s 118-565(1)(b)-(c).
[141] ITAA 1997 ss 124-790, 116-20(1)(b). See also, Australian Taxation Office, *Income Tax: Capital Gains tax: Partial scrip for scrip roll-over: ineligible proceeds* (ATO ID 2002/100, 30 January 2002).
[142] ITAA 1997 ss 104-25(1)(b), 116-20(1)(b), 110-25(2)(b).
[143] See also, Buddy Platform Limited, *ASX Market Release – Acquisition of Leading Global Smart Light Company LIFX* (6 February 2019) Australian Securities Exchange < https://www.asx.com.au/asxpdf/20190206/pdf/442dtqffzz8ljw.pdf >; *General Corporation Law of the State of Delaware* 8 DGCL § 252(b)(5) (Delaware Code Online); Australian Taxation Office, *Income tax: scrip for scrip roll-over - exchange of units in The Airlie Share Fund for units in The Airlie Concentrated Share Fund*, CR 2016/45, 22 June 2016; Australian Taxation Office, *Income tax: Accenture Group reorganisation - scrip for scrip roll-over: exchange of Accenture Limited shares for equivalent Accenture plc shares* (CR 2010/72, 8 December 2010).
[144] ITAA 1997 s 118-565(1)(e).

years, this is not an unreasonable limitation on the regime.[145] However, this means that longer term arrangements, for example, royalty-based arrangements typically seen in the sale of mining assets, would not qualify for look-through treatment.[146]

Contingent on economic performance

For a right to qualify as a 'look-through earnout right', the financial benefits provided under the right must be contingent on the economic performance of the underlying CGT asset (or business).[147] According to the Explanatory Memorandum introducing the regime, 'economic performance' is a "flexible and wide concept" encompassing the success of the economic activities of the business.[148] It would typically include financial measures such as profit, sales or turnover of a business, or non-financial measures such as number of clients retained or attracted.[149]

The meaning of 'economic performance' was recently considered by the majority of the Full Federal Court in *Merchant*, where the Court noted that economic performance "may be measured in different ways and for different purposes" and "is not limited to accounting concepts of net profit or gross profit or a variation to those concepts."

When it comes to non-financial measures (e.g. employee retention), significant uncertainty remains as to whether the requisite nexus to economic performance exists. In particular, notwithstanding the commentary in the Explanatory Memorandum acknowledging that economic performance is intended to be a "flexible and wide concept", the ATO has at times applied this requirement quite narrowly, accepting in some cases that a contingency relating to employee retention will be relevantly contingent on economic performance whilst declining to do so in others.[150]

There is also uncertainty about how the condition should apply where a financial benefit is contingent on a combination of financial and non-financial measures (e.g. profitability or turnover, and retention of key employees), some of which clearly relate to 'economic performance' and others which may not. On one view, the absence of the limiting adverb 'only' from the phrase 'contingent on the economic performance' may mean that, provided at least one of the contingencies clearly relates to economic performance, the condition should be satisfied. The Board of Tax also identified these challenges and thought additional ATO guidance on this limb of the look-through earnout right test would be helpful for taxpayers.[151] No such ATO guidance has been forthcoming since the report was published.

A contingency subject to the performance of 'financial indices', or the discovery of further information about an existing asset would also not typically satisfy this requirement.[152]

As mentioned above, the right to receive the additional consideration granted to the shareholders in the Highlands example was contingent on the performance of the spot price of nickel. The right conferred on shareholders is also unlikely to have satisfied this limb of a look-through earnout right on the basis that the additional consideration was not 'contingent on the economic performance' of the target's business, unless it could be established that the performance of the spot price of nickel was a reasonable indicator of the

[145] Ninon Kohers and James Ang, 'Earnouts in Mergers: Agreeing to Disagree and Agreeing to Stay' (2000) 73 Journal of Business 445, 445-457.
[146] See, e.g., *Cliffs International; Ivanac v Deputy Federal Commissioner of Taxation* (1995) 60 FCR 417.
[147] ITAA 1997 s 118-565(1)(f).
[148] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth) [1.51].
[149] Ibid, [1.53].
[150] See eg PBR 1051659115719. Cf PBR: 1052020371737 and PBR 1052020105622.
[151] Board of Tax Paper, n 16 at [2.32]ff.
[152] Ibid, [1.54]-[1.55].

economic performance of that business – which may have been the case, for example, if the only activities of the company comprised the production of nickel.

Active asset test and widely held companies

For a right to qualify as a 'look-through earnout right', it must be created under an arrangement involving the disposal of a CGT asset which, just before the disposal, was an 'active asset' of the entity disposing of the asset.[153] As noted above, the definition of an active asset is expanded for the purposes of the earnout regime. The general meaning of that phrase derives from the small business tax concessions in Subdivision 152-A of the ITAA 1997. Relevantly, a share in a company or a unit in a trust will be an active asset of an entity if:[154]

- the market value of the assets that are used, or held ready for use, by the company or trust in the course of carrying on a business are at least 80% of the market value of all of the assets of the company or trust; and
- if the company or trust is 'widely held', then the entity is a 'CGT concession stakeholder' of the company or trust, which broadly requires that the entity must hold an interest of greater than 20% in the company or trust.[155]

Under the additional 'active asset' test under the earnout regime, the first test is modified by considering (among other things) whether the derivation of assessable income from the business carried on by the entity is 80% or more than the passive income derived by that entity.[156]

More importantly, under the general and expanded active asset tests, a shareholder or unitholder in a widely-held company or trust would not qualify for 'look-through' treatment, unless their interest in the company or trust is greater than 20%.[157] (Very broadly, a company (or trust) will be 'widely held' if it is listed on an approved stock exchange or has more than 50 members, subject to certain closely held restrictions.)[158]

By way of example, in Class Ruling CR 2022/63 (Crestone Holdings Limited – Scheme of arrangement and dividends),[159] the ATO ruled that a right granted to shareholders to receive additional consideration for the sale of their shares in Crestone – where that additional consideration was subject to the company meeting certain performance hurdles – would **not** qualify as a 'look-through earnout right' for the purposes of Subdivision 118-I of the ITAA 1997 on the basis that no shareholder satisfied the active asset test. It concluded:[160]

> The Earnout Right is not a look-through earnout right under subsection 118-565(1) and the rules in Subdivision 118-I do not apply to the Earnout Right.
>
> ….
>
> **As there was no CHL shareholder that held a greater than 10% interest in CHL, there was no CHL shareholder that was either a CGT concession stakeholder of CHL or had a small business participation percentage in CHL of at least 20%** (paragraph 118-570(1)(c)). Accordingly, the CHL share was not an active asset of a CHL shareholder just before CGT event A1 happened to the CHL share, and the Earnout Right will not

[153] ITAA 1997 s 118-565(1)(d).
[154] ITAA 1997 ss 152-40(1), (3), (4)(b)-(c), (5), 995-1(1) (definition of 'widely held company').
[155] ITAA 1997 ss 152-50, 152-55, 152-60, 152-65, 152-70.
[156] ITAA 1997 s 118-570(1)(e).
[157] Under s 118-570, the additional active asset test requires the entity to be a 'CGT concession stakeholder' or otherwise (if the entity is not an individual) to hold a 'small business participation interest in the company or trust of at least 20%
[158] ITAA 1997 ss 995(1) and 152-40(5).
[159] Australian Taxation Office, *Crestone Holdings Limited – scheme of arrangement and dividends* (CR 2022/63, 13 July 2022).
[160] Ibid, [28], [124].

> be a look-through earnout right under subsection 118-565(1). Accordingly, Subdivision 118-I will not apply to the Earnout Right.

According to the Explanatory Memorandum for the earnout regime, this requirement "reflects the intention of the amendments to apply to disposals of a business, not to the sale of a passive investment.'[161] This rationale is somewhat difficult to follow and perhaps erroneously proceeds on the assumption that all owners of private or closely held entities hold their interests in those entities otherwise than as a passive investment.

In any event, while the CGT concession stakeholder requirement may be appropriate for the purposes of applying the small business tax concessions, which may, in some cases, provide a complete exemption to a capital gain made on the disposal of a business,[162] it seems to impose an unduly restrictive condition on a regime that is intended to facilitate the liquidity of business assets by providing what may only be a very limited deferral of tax.

Although earnout arrangements are less common in a public market context, they are not entirely novel. In addition to the Crestone example above, the proposed scheme of arrangement involving TPC Consolidated Limited (ASX:TPC) announced in 2024 is another recent example of a public market transaction where the proposed scheme consideration includes an earnout component. There was also an earnout component as part of the scheme consideration offered to shareholders of Bingo Industries Limited (ASX:BIN) in 2021.

Active asset test and consolidated groups

As noted above, the 'active asset' condition states in subsection 118-565(1)(d):

> (d) **just before the CGT event**, the CGT asset was an active asset of the entity who disposed of the asset;

The CGT event must be CGT event A1, and typically, the CGT event will happen when a contract for the disposal of the asset is entered into.[163]

Based on the wording of s 118-565(1)(d), it is not clear whether a disposal by a head company of a tax consolidated group of shares in a subsidiary member could be a qualifying active asset if, *just before* the disposal of the shares in the subsidiary member, the shares are disregarded for tax purposes because of the single entity rule.

Interestingly, under the additional active asset test, the company (or trust) in which shares (or trust interests) are disposed must **not** be a subsidiary member of a tax consolidated group:[164]

> (d) at that time, the company or trust:
>
> (i) is carrying on a *business, and has been carrying on a business since the start of the most recent income year ending before that time; and
>
> **(ii) is not a *subsidiary member of a *consolidated group; and**

On one view, therefore, the additional active asset test implies that shares or trust interests in an entity that is a subsidiary member of a tax consolidated group would – in the absence of the exclusion under paragraph (d)(ii)– be capable of satisfying the additional active asset test. If that is the correct view, interests in a subsidiary member should be capable of being active assets under the general test. The ATO does not appear to have published any guidance on this issue.

[161] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth) [1.44].
[162] See, e.g., ITAA 1997 s 152-105.
[163] ITAA 1997 s 104-10(3).
[164] ITAA 1997 s 118-570(1)(d).

What is apparent from the discussion above is that there may be several reasons why an arrangement may not qualify for 'look-through' treatment. According to the ATO Discussion Paper, the ATO confirmed that the views expressed in the Draft Taxation Ruling continue to apply to arrangements that do not qualify for look-through treatment.[165] This means there are a number of cases in which the difficulties with the ATO's separate asset approach, set out above, may still arise.

4.4 A potential TOFA overlay

4.4.1 Introduction

The TOFA regime may offer a potential solution to mitigate some of the adverse effects of the ATO's separate asset approach for non-qualifying earnout arrangements.

A key benefit of accounting for an earnout arrangement under Division 230 is that, generally speaking, it is intended to ensure that there is 'symmetry' between the amount subject to tax for the disposal of the asset under the CGT regime and the amount subsequently brought to account under Division 230, meaning there is no 'overlap or gap' between the operation of the two regimes.[166]

Division 230 of the ITAA 1997 allows qualifying taxpayers to recognise gains and losses, as appropriate, over the life of a 'financial arrangement' and ignore distinctions between income and capital unless specific rules apply.[167]

A 'financial arrangement' is defined in s 230-45(1) to mean an 'arrangement' where there are 'cash settlable' legal or equitable rights (or obligations) to receive (or provide) a financial benefit, unless (a) there are one or more legal or equitable rights (or obligations) to receive (or provide) something which is **not** a financial benefit or something which is **not** cash settlable, and (b) the rights (or obligations) are not insignificant in comparison with the cash settlable financial benefits. A 'financial benefit' is defined to mean anything of economic value.[168] A right or obligation that is subject to a contingency is still a right or obligation for the purposes of Division 230.[169] For present purposes, it is relevant to note that something will be considered cash settlable if (among other things) it is money or a money equivalent.[170]

The term 'arrangement' is defined broadly by reference to the s 995-1 definition:

> ***arrangement*** means any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

There are specific grouping and disaggregation rules that may apply when determining whether particular rights or obligations are themselves an 'arrangement' or two or more separate arrangements.[171]

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[165] ATO Discussion Paper, [7].
[166] Explanatory Memorandum, *Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008* [3.46]- [3.47].
[167] Under s 230-15, the assessable income of a taxpayer includes a gain made from a 'financial arrangement', and a taxpayer can deduct a loss made from a financial arrangement to the extent that it is made in gaining or producing assessable income (or necessarily made in carrying on a business for that purpose).
[168] ITAA 1997 s 974-160.
[169] ITAA 1997 s 230-85.
[170] ITAA 1997 s 230-45(2)
[171] ITAA 1997 s 230-55.

An 'equity interest' or a legal or equitable right to receive or provide something that is an equity interest is also a 'financial arrangement'.[172] Division 230 is subject to various exceptions including particular types of taxpayers or arrangements or rights and obligations under an arrangement.[173]

Where Division 230 applies to a financial arrangement, it generally has priority in application to other provisions of the tax law.[174] For CGT purposes, a capital gain or loss is disregarded where it is made from a CGT asset (or the creation of a CGT asset) or from a discharge of a liability, if, at the time of the CGT event, the asset or liability is part of a financial arrangement for Division 230 purposes.[175]

4.4.2 Application of TOFA to earnout arrangements that do not qualify as 'look-through earnout rights'

Broadly, under s 230-505, if a qualifying earnout 'financial arrangement' is provided in consideration for the sale of an asset, the market value of the asset would be included in the 'capital proceeds' (and 'cost base') for CGT purposes at the time the asset is 'provided' (or 'acquired') (i.e., at settlement, not at the time of signing the contract),[176] and the seller and buyer would then each hold the earnout (financial) arrangement with a cost equal to the market value of that part of the asset provided to start holding the financial arrangement (i.e. the market value of the earnout).[177]

Broadly, each party would then make a revenue gain or a loss to the extent that the subsequent payments made under the earnout (financial) arrangement exceed the initial 'cost' of the arrangement,[178] and would account for those gains or losses depending on, amongst other things, the certainty or likelihood of those payments being made and any elections the parties may have made. This can be summarised as follows:

	Tax on grant of the right	**Tax on further payments**
Seller	Capital proceeds for disposal of asset equal to market value of asset at the time it is provided[179]	Cost of earnout 'financial arrangement' (ie the financial benefit provided) is the value of the asset attributable to the earnout right (effectively the market value of earnout right)[180] The difference between the cost and the amounts actually received is a TOFA gain (or loss)
Buyer	Cost base for acquisition of asset equal to market value of asset at the time it is acquired[181]	Proceeds from earnout 'financial arrangement' (i.e. the financial benefit received) is the value of the asset attributable to the earnout obligation

[172] ITAA 1997 s 230-50. Generally speaking, where an arrangement satisfies the definition of a financial arrangement under s 230-45 and s 230-50(1), s 230-50 will apply: see Taxation Determination TD 2011/12. However, TOFA will only apply to an equity interest 'financial arrangement' where the entity has made certain TOFA elections (e.g., a fair value election).
[173] ITAA 1997 Subdivision 230-H.
[174] ITAA 1997 s 230-20, s 230-25.
[175] ITAA 1997 s 118-27.
[176] ITAA 1997 s 230-505(2).
[177] ITAA 1997 ss 230-505(2), (7)-(8).
[178] ITAA 1997 ss 230-15(1)-(2), 230-445(1).
[179] ITAA 1997 s 230-505(2).
[180] ITAA 1997 s 230-60(1)
[181] ITAA 1997 s 230-505(2).

	No CGT event D1 because the creation of a CGT asset is part of a Division 230 financial arrangement under anti-overlap rule?[182]	(effectively the market value of earnout obligation)[183] The difference between the proceeds and the amounts actually paid is a TOFA loss (or gain)

4.4.3 Challenges with applying TOFA to earnout arrangements

There are a number of threshold issues when applying Division 230 to earnout arrangements, which we address in turn below.

- **Qualifying taxpayers.** Division 230 will generally not apply to individuals and other entities that do not meet certain turnover or asset thresholds,[184] unless they make an irrevocable election to apply the division to all their financial arrangements;[185]
- **Short-term arrangements.** Division 230 will not apply where a taxpayer is required to provide financial benefits under a financial arrangement in consideration for property that the taxpayer has acquired (or provided), and the time of acquisition until the time the taxpayer is to provide (or receive) the consideration (or a substantial proportion of it) is not more than **12 months**.[186]
- **Financial arrangements.** The earnout arrangement must qualify as a 'financial arrangement' (as defined). The grouping and disaggregation rules discussed above are particularly important in this context to determine whether there is one financial arrangement (e.g. the sale contract) or more than one financial arrangement (e.g. each right to receive a particular earnout amount itself is a financial arrangement). If, for example, there are significant non-cash financial benefits under the arrangement (e.g. if the earnout consideration comprises shares which are not 'cash settlable'), the earnout may not qualify as a 'financial arrangement'.

  In *Merchant*, the Commissioner argued that certain rights to information and undertakings imposed on the parties (e.g. not to engage in a competitive business or solicit clients) during the earnout period were 'not insignificant', and therefore, the right to receive the earnout amounts in that case was not a qualifying 'financial arrangement' for the purposes of Division 230. The ATO had raised a similar issue in the ATO Discussion Paper in 2018. Justice Thawley (at first instance) did not have to decide the matter (because his Honour held that the exception in s 230-460(13) applied (see below)) – however, if it had been necessary to decide, his Honour would have been inclined to conclude that those rights were "insignificant in comparison to the right" to receive the future earnout payments.

  On appeal, Logan J agreed and noted that – although not strictly necessary to express a view on the issue – the right to receive the earnout was capable of constituting a 'financial arrangement' for the purposes of s 230-45. The majority (McElwaine and Hespe JJ) on appeal did not consider it necessary to express a view on this issue having regard to their findings on the TOFA exception in s 230-460(13) (see below).

[182] ITAA 1997 s 118-27(1).
[183] ITAA 1997 s 230-60(2).
[184] ITAA 1997 s 230-455(1)-(5).
[185] ITAA 1997 s 230-455(6)-(8).
[186] ITAA 1997 s 230-450.

- **Equity interests.** As noted above, 'equity interests' (as defined in Division 974) are treated as a category of financial arrangement for the purposes of Division 230; however, Division 230 will not apply to the arrangement unless the taxpayer has made a TOFA election.

  The ATO Discussion Paper raises the possibility of certain earnout arrangements being treated as 'equity interests' for the purposes of Division 974.[187] One of the requirements for an arrangement to be an 'equity interest' is that it must be a 'financing arrangement'[188] – that is, among other things, it must be entered into or undertaken to raise finance for the entity (or a connected entity).[189] Most earnout arrangements are **not** used as a form of vendor finance, but rather are designed to resolve differences as to the valuation of the underlying asset – where that is the case, the arrangement should **not** be treated as an equity interest for Division 974 purposes. As an aside, this view may be contrary to the basis on which the exclusion to CGT event D1 ('borrowing money' or 'obtaining credit') may apply.

- **Proceeds from sale of business.** A key reason many earnout arrangements are not subject to Division 230 is because of the TOFA exclusion relating to business sales. Under s 230-460(13), financial benefits arising from the sale of a business (or an entity that operates a business) are the subject of an exception if the amounts, or the values, of the financial benefits are only 'contingent on aspects of the economic performance of the business' after the sale. In particular, the section provides:

  > Proceeds from certain business sales
  >
  > (13) A right to receive, or an obligation to provide, *financial benefits arising from the sale of:
  >
  > (a) a business; or
  >
  > (b) shares in a company that operates a business; or
  >
  > (c) interests in a trust that operates a business;
  >
  > is the subject of an exception if the amounts, or the values, of those benefits are only *contingent on aspects of the economic performance of the business after the sale.

  The phrase 'contingent on aspects of economic performance' is defined in s 974-85(1) as follows:

  > A right, or the amount of a return, is contingent on aspects of the economic performance of an entity, or a part of the entity's activities, if the right or return is contingent on the economic performance of that entity, or that part of those activities, but not solely because of one of the following:
  >
  > (a) the ability or willingness of an entity to meet the obligation to satisfy the right to the return;
  >
  > (b) the receipts or turnover of the entity or the turnover generated by those activities.

  An amount will therefore be 'contingent aspects of economic performance' (as defined) where it is contingent on the economic performance of the entity but **not** solely because of the receipts or turnover of the business (or otherwise the ability or willingness of an entity to meet the obligation).

  As a practical matter, this exclusion is likely to disqualify most standard earnout arrangements from TOFA treatment, except those arrangements that are contingent only on the receipt or turnover of the entity after the sale.

[187] ATO Discussion Paper, [55]-[58].
[188] ITAA 1997 s 974-75(2).
[189] ITAA 1997 s 974-130(1).

Merchant

Subsection 230-460(13) was amended in 2016 by the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016*. Former subsection (13) was expressed in the same terms as the current provision, except the postscript read as follows:

> […] is the subject of an exception if the amounts, or the values, of those benefits are ~~only *contingent on aspects of the economic performance~~ contingent only on the economic performance of the business after the sale.

In *Merchant v Commissioner of Taxation* [2024] FCA 498, Thawley J was required to consider whether the exception in former s 230-460(13) applied to an earnout arrangement where deferred payments were subject to (i) formal corporate approval for a capital expenditure program (the 'Extrusion Coating Milestone'), and (ii) certain sale volume metrics being satisfied. The taxpayer argued that these contingencies meant that the payment of the earnout amounts were **not** 'contingent only on the economic performance of the business after sale' in the sense required by former subsection (13), and therefore the exception did not apply. This was because, the taxpayer submitted, 'economic performance', when read in conjunction with the definition in s 974-85(1), was directed at 'profitability'.

At first instance, Thawley J noted that, at the relevant time, s 974-85(1) defined the phrase 'contingent on the economic performance' but that the definition did **not** apply to s 230-460(13), which used the term 'contingent only on the economic performance'.[190] Nor was that phrase the same as the word 'profitability'. His Honour held:

> The words "contingent only on the economic performance of the business after the sale" mean what they say. The phrase "economic performance" is not the same as, or equivalent to, the word "profitability". Profitability is one way to measure the success or otherwise of a business's "economic performance", but "economic performance" refers to a business's performance, not its profitability.
>
> If the legislature had wanted to limit the exception to profitability, it could have done so by using the phrase "contingent only on the profit of the business after sale".
>
> It is clear enough that the exception was intended to address, amongst other things, earn-out arrangements. These are commonly structured by reference to performance of the business other than by way of profit. Earn-out arrangements might be structured, for example, by reference to numbers of clients retained or gained or volume of sales. These are both appropriately described as matters of "economic performance". They are indicators of performance or profitability and are commonly used because they do not turn on choices that the incoming purchaser might make about business operations or the cost of sales being matters which affect profitability.

Justice Thawley therefore concluded that the relevant earnout payments were 'contingent only on the economic performance of the business' after the sale, and therefore, the arrangement was within the exception set out in s 230-460(13). His Honour's reasoning on this point was not disturbed on appeal to the Full Federal Court in *Merchant*, although McElwaine and Hespe JJ approached the issue in a slightly different way.

Similar to Thawley J, their Honours agreed that the expression 'contingent only on the economic performance' should bear its ordinary meaning, and therefore, that economic performance should not be confined to profitability. However, their Honours proceeded on the basis that, at the time the relevant rights expired, the only remaining contingency related to sales turnover – a contingency plainly referable to the economic performance of the business – the Extrusion Coating Milestone having already been satisfied by that time. Their Honours, therefore, did not need to express a view on whether the Extrusion Coating Milestone was itself a contingency relating to economic performance.

[190] *Merchant v Commissioner of Taxation* [2024] FCA 498, 636.

Instead, McElwaine and Hespe JJ relied on note 1 to s 230-45, which provides that rights and obligations under an arrangement can change over time, such that an arrangement which does not initially constitute a qualifying 'financial arrangement' may subsequently become one. This approach allowed their Honours to resolve the appeal without needing to address the more difficult question of whether the Extrusion Coating Milestone was also properly characterised as a contingency relating to economic performance. As at the date of this paper, the taxpayer has filed for special leave to appeal to the High Court, which was granted on 9 October 2025 and the appeal heard on 17 and 18 March 2026. The taxpayer's submissions on appeal, however, do not appear to extend to the TOFA aspects of the Federal Court's decision.

What is the correct scope of the exclusion?

As noted above, the look-through earnout right regime in Subdivision 118-I now uses the phrase ‘contingent on economic performance.'

When the earnout regime was enacted, certain consequential changes were made, including that:

- the phrase ‘contingent only on the economic performance’ previously used in s 230-460(13) was replaced with ‘contingent on aspects of the economic performance’; and[191]
- the definition in s 974-85(1) was changed to ‘contingent on aspects of economic performance’ which continues to be defined in exactly the same way as ‘contingent on economic performance’ was previously.[192]

The Explanatory Memorandum confirms that the concept of ‘contingent on economic performance’ was intended to be wider, noting that deferred consideration which is calculated by reference to business receipts or turnover should not be excluded from the measure and to do so would ‘unduly limit the scope of the [look-through earnout] concession’.[193]

Based on the above, therefore, the exclusion in s 230-460(13) now appears to be tied to the definition in s 974-85(1), unlike the exclusion considered by the Court in *Merchant*.

There is some uncertainty, however, about the scope of the change made to s 230-460(13). In particular, the consequential changes discussed above were made by Part 3 of the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* (Cth). The ‘Application’ part of the Act states:

> **38 Application of amendments**
>
> The amendments made by **Parts 1 to 3 apply in relation to look-through earnout rights** created on or after 24 April 2015. [emphasis added]

It is not clear, therefore, whether the consequential amendments should apply for all purposes or only for “look-through earnout rights” created on or after 24 April 2015’. Where, for example, an arrangement does not qualify as a look-through earnout right under s 118-565, it is not clear whether the TOFA exclusion under s 230-460(13) should be read having regard to the changes made by the Act (in which case, the definition in s 974-85(1) would apply) or not (in which case, the position as set out in Merchant would still be relevant).

The ATO has acknowledged the apparent uncertainty about how the amendment should apply:[194]

[191] *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth) Item 21, Part 3.
[192] Ibid, Item 27, Part 3; Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth) [1.143].
[193] Explanatory Memorandum, *Tax and Superannuation Laws Amendment (2015 Measures No.6) Bill 2015* (Cth), [2.184] to [2.186].
[194] ATO Discussion Paper, footnote 41.

> Notwithstanding the literal wording of the application provision, it is not clear whether the amendment was intended to be limited only to look-through earnout rights such that the former version of subsection 230-460(13) continues to apply to all other types of earnout rights.

More recent ATO website guidance, however, seems to proceed on the basis that the definition in s 974-85(1) would continue to apply even where the arrangement is **not** a look-through earnout right (as defined).[195]

4.4.4 Application of TOFA to earnout arrangements that qualify as 'look-through earnout rights'

Where an arrangement qualifies as a 'look-through earnout right' under Subdivision 118-I but is also subject to Division 230, the interaction of the CGT rules and the TOFA provisions is not clear. As a practical matter, this is likely to arise where there is an earnout arrangement that is calculated only by reference to receipts or turnover and 'contingent on economic performance' (for the purposes of Subdivision 118-I) but **not** 'contingent on *aspects of* economic performance' (for the purposes of s 230-460(13)).

In these circumstances, under s 230-505, the market value of the business asset would be included in capital proceeds (and cost base) for CGT purposes at the time the asset is provided (or acquired); however, it is not clear whether ss 112-36 and 116-120 would also operate to exclude the market value of the look-through earnout right.

Section 230-505 is stated to apply "…for the purposes of applying this Act …"; however, according to the Explanatory Memorandum introducing the TOFA rules, s 230-505 is **not** intended to operate to affect the capital proceeds and cost base modification rules, which would include the look-through earnout right rules in ss 112-36 and 116-120, each of which is stated to be a 'modification' to the general rules governing cost base and capital proceeds:

> Section 230-505 operates in relation to certain elements of capital proceeds, cost base, cost of a depreciating asset and termination values. However, it does not in general affect the modification rules, special rules and specific rules in the capital gains and capital allowance regimes (e.g. the market value substitution rules).[196]

If, for example, the seller is **not** required to include the market value of the earnout right in capital proceeds because of s 116-120(1), but the market value of the earnout right is still recognised in the cost of the 'financial arrangement' for the purposes of Division 230,[197] then to the extent the amount actually received by the seller exceeds the cost of the financial arrangement, the seller would recognise a gain under TOFA **but** would not be required to adjust its capital proceeds. This is because, under s 230-25, financial benefits in relation to TOFA financial arrangements are only taken into account once under the Act. Based on this view, the seller would calculate its gain (or loss) on the earnout (financial) arrangement for TOFA purposes having regard to the market value of the earnout without being subject to tax on that amount at the time of disposal.

By way of example, if the market value of the earnout right is $60, and the actual earnout payment is $90, based on the above, the seller would not be required to include the market value of the earnout right in capital proceeds (because of s 116-120(1)) and would only be required to include $30 (as a gain on a TOFA financial

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[195] 'How to identify the arrangement being tested so you can determine whether an arrangement is a financial arrangement', *Australian Taxation Office* (Web Page, 16 June 2023) <https://www.ato.gov.au/businesses-and-organisations/corporate-tax-measures-and-assurance/taxation-of-financial-arrangements-tofa/in-detail/guide-to-the-taxation-of-financial-arrangements-tofa/what-the-rules-apply-to>.
[196] Ibid, [11.55].
[197] ITAA 1997 s 230-60(1).

arrangement) in its assessable income despite making an overall economic gain of $90.[198] On the other hand, the buyer would only recognise $30 for tax purposes despite an overall economic outflow of $90.

The ATO seems to have rejected this approach.

In PBR Authorisation Number 1052127421665, the ATO ruled that s 230-505 should apply to allow the buyer to include the market value of a look-through earnout right in the cost base of the shares in the target company. In the ATO's view, ss 230-20 and 230-25, together with s 230-505, have 'priority' and will 'over-ride' the look-through earnout rules in the CGT regime. The buyer in that case would then claim a loss to the extent the actual earnout payments were greater than the market value of the earnout right (or a gain to the extent they were less), but the earnout payments would not be included in the cost base of the shares.[199]

[198] See also Board of Tax Paper, Example 2.1.
[199] See also 'Earnout and deferred consideration arrangements', *Australian Taxation Office* (Web Page, 30 May 2024) <https://www.ato.gov.au/forms-and-instructions/capital-gains-tax-guide-2024/about-capital-gains-tax/earnout-and-deferred-consideration-arrangements>.

5. CGT Roll-overs in M&A

5.1 Recent Transactions – Brickworks/Soul Patts

5.1.1 Introduction

In September 2025, Brickworks Limited (**Brickworks**) and Washington H. Soul Pattinson and Company Limited (**Soul Patts**) combined via two separate but inter-conditional schemes of arrangement under the Corporations Act 2001 (Cth).

The transaction is interesting because, rather than one entity acquiring another, both entities were 'top-hatted' with shareholders rolling into a single newly established holding company (**TopCo**) which was subsequently listed on the ASX.

The background to this transaction structure was an existing crossholding between Brickworks and Soul Patts, under which Soul Patts held 42.92% of the shares in Brickworks and Brickworks held 25.64% of the shares in Soul Patts. The crossholding was first established in 1969 as a way to "strengthen diversification" and to defend against hostile takeovers by making the companies more difficult to acquire.[200]

5.1.2 The transaction

Broadly, the combination involved the following steps:

1. Prior to the implementation of the Brickworks scheme and the Soul Patts scheme, TopCo undertook a capital raising of approximately $1.4 billion by issuing 34 million new shares to new investors.

2. Under a scheme of arrangement, a newly established subsidiary of TopCo (**SubCo**) acquired all of the shares in Brickworks, including the shares held by Soul Patts, in exchange for 0.82 shares in TopCo per Brickworks share. This created a new crossholding between TopCo and Soul Patts.

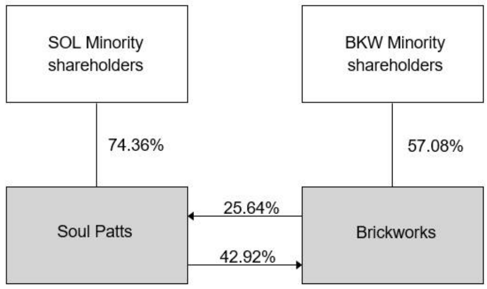
3. Under a separate scheme of arrangement, SubCo acquired all of the shares in Soul Patts held by public shareholders (i.e. excluding the shares held by Brickworks, which were not acquired under the scheme because Brickworks would itself become a subsidiary of TopCo) in exchange for 1 TopCo share per Soul Patts share.

4. The shares held by Soul Patts in TopCo were subject to a selective buy-back shortly after implementation of the two schemes, with the shares to be cancelled following the buy-back. This removed the crossholding between TopCo and Soul Patts.

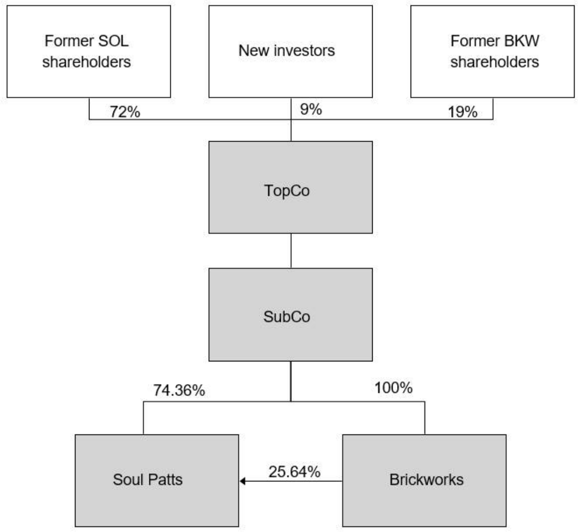
Pre and post-transaction structure diagrams are shown on the next page.

[200] Brickworks Limited, Combination Booklet (4 August 2025), p. 37.

Before Implementation



After Implementation



5.1.3 Potential tax consequences of roll-over

Perhaps due to the unusual transaction structure, it was a condition precedent under the Combination Deed that each of Brickworks and Soul Patts received, by 8:00am on the Second Court Date, confirmation from the ATO to the effect that the Commissioner of Taxation was prepared to issue a ruling confirming the availability of scrip for scrip roll-over relief under Subdivision 124-M in connection with each scheme. The ATO issued positive class rulings confirming the availability of roll-over relief in CR 2025/71 (Soul Patts) and CR 2025/72 (Brickworks).

It was also a condition precedent that TopCo had received confirmation from the ATO that it was prepared to issue a private binding ruling regarding the income tax consequences for TopCo of the various transactions involved in the combination. While the TopCo private ruling is not publicly available, we expect the ruling would have confirmed the potential tax consolidation outcomes for TopCo which would have included confirmation about the tax cost base of the Brickworks and Soul Patts shares acquired by TopCo for consolidation cost setting purposes. (The ATO class rulings confirmed TopCo was the head company of an income tax consolidated group).

Based on the sequencing of the transaction, it is possible that the cost base of the shares acquired by TopCo/SubCo in Brickworks and Soul Patts were each equal to the market value of the shares on the scheme implementation date rather than being determined under s 124-784B, on the basis that the requirements for the arrangement to be treated as a 'restructure' under s 124-784A may **not** have been satisfied.

This is principally due to the capital raising undertaken by TopCo under Step 1 (approximately $1.4 billion):

- The market value of shares issued in TopCo to former Brickworks shareholders under Step 2 may not have exceeded 80% of the total market value of shares on issue in TopCo at completion of the arrangement: see s 124-784A(2). At the time of implementation, Brickworks' market capitalisation was approximately $5.1 billion, meaning that the market value of shares issued to former Brickworks shareholders – assuming all Brickworks shareholders became shareholders in TopCo – represented approximately 78.5% of the total market value of shares on issue (this percentage may have been lower depending on the number of 'Ineligible Foreign Shareholders' who were cashed out under the sale facility).

- Similarly, at the time the shares in Soul Patts were acquired by SubCo under Step 3, the market capitalisation of Soul Patts was approximately $16.9 billion, meaning that the market value of shares issued to former Soul Patts shareholders – assuming all Soul Patts shareholders became shareholders in TopCo – represented approximately 72% of the total market value of shares on issue in TopCo, having regard to the shares issued in connection with the capital raising (under Step 1) and the shares issued to former Brickworks shareholders (under Step 2).

5.2 Recent Transactions – Millennium Scheme

5.2.1 Introduction

In May 2024, Millennium Services Group Limited (**Millennium**), a cleaning, security, waste management, maintenance and property services business, was acquired by MS Journey Pty Ltd (SoftBank Robotics BidCo), a subsidiary of SoftBank Robotics Singapore Pte. Ltd. (**SBRS**), via a scheme of arrangement under the *Corporations Act 2001* (Cth).

Under the scheme, shareholders of Millennium could exchange their shares for either (at each shareholder's election) cash, scrip or mixed consideration (further details on this below).

Millennium applied for a class ruling from the ATO confirming the availability of scrip for scrip roll-over under Subdivision 124-M for shareholders who elected to receive the scrip consideration. A positive ruling was issued by the ATO on 4 September 2024.[201]

The transaction is interesting because Millennium shareholders who received scrip did not roll into the ultimate parent of the SoftBank Group – SoftBank Group Corp., a Japanese incorporated company.

5.2.2 The 'ultimate holding company' requirement

As a refresher, s 124-780 permits roll-over of a capital gain in circumstances where a taxpayer exchanges shares, options or rights in a company (the 'original entity') for 'replacement interests' in another company, provided the conditions for roll-over are met. This section is commonly relied upon in scheme transactions where target shareholders are offered scrip in exchange for transferring their shares to the bidder.

One such roll-over condition is that, where the entity which acquires the shares in the original entity is a member of a 'wholly-owned group', the replacement interests issued to target shareholders must be in a company that is the 'ultimate holding company' of the wholly-owned group.[202] Under s 124-780(7), a company is the 'ultimate holding company' of a wholly-owned group if it is not a 100% subsidiary of another company in the group.

In the Millennium scheme, shareholders who elected to receive scrip were issued Class B shares in MXS Ventures Pte. Ltd. (**HoldCo**), a Singaporean company incorporated a few days prior to execution of the SID.[203]

[201] Class Ruling 2024/55, *Millennium Services Group Limited - scrip for scrip roll-over*.
[202] ITAA 1997, ss 124-780(3)(c)(ii), 975-500 and 975-505.
[203] Millenium Services Group, ASX Announcement, 'Scheme Booklet Registered with ASIC' (12 March 2024), p. 65.

However, the structure of the scheme consideration was such that only Millennium shareholders with very substantial holdings were eligible to elect to receive the scrip consideration. Under the SID, 'Small Shareholders' (being shareholders holding fewer than 300,000 Millennium shares) were not eligible to elect to receive scrip and would instead receive A$1.15 cash per Millennium share.[204] This represented a very small pool of shareholders largely made up of key management personnel (Millennium announced on 12 April 2024 that only four shareholders collectively holding around 14.35 million shares had elected to receive scrip, representing 30.43% of all Millennium shares).[205] It was also a condition precedent to the scheme that 'Key Rolling Shareholders' (being certain key management personnel) had elected to receive scrip representing not less than 14.15 million Millennium shares in aggregate.

Offering unlisted shares in the bidder to target shareholders in a public M&A transaction is commonly referred to as 'stub equity' and is often used to retain key founders or management.

The initial shareholdings in HoldCo were as follows:

1. 100% of the Class A shares were held by SBRS, a Singaporean company; and
2. 100% of the Class C shares (i.e. a single share with very limited voting rights) were held by an individual, Mr Terence Yap.[206]

SBRS is wholly owned by SoftBank Robotics Group Corp (a Japanese company), which in turn is wholly owned by SoftBank Group Corp (the ultimate parent).

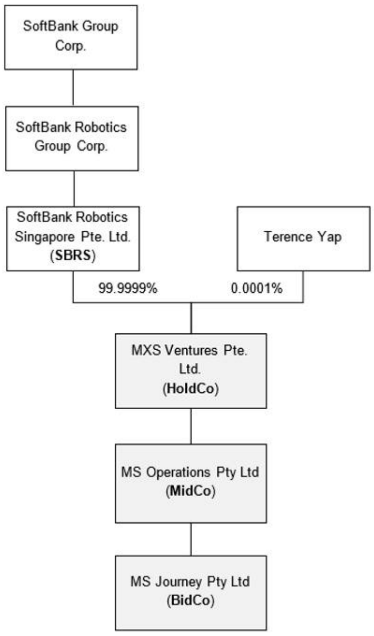
SBRS held approximately 99.9999% of the HoldCo shares at incorporation, with Mr Yap holding the remaining 0.0001%. HoldCo itself held 100% of the shares in two newly incorporated Australian companies, forming a triple-stack holding structure.

According to the Scheme Booklet, Terence Yap's single Class C share was to be transferred to SBRS 'as soon as practicable' on implementation of the scheme.[207]

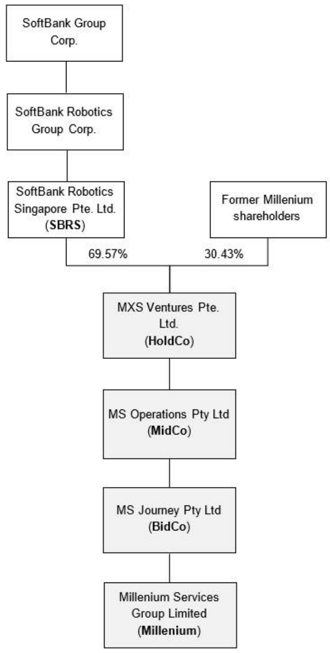
The pre- and post-Implementation structure is shown below.

[204] Note that the election also subject to a 'scaleback' mechanism under which, if shareholders elected to receive scrip in relation to greater than 45% of Millenium shares, the amount of overall scrip issued would be 'scaled back' to 45% on a pro rata basis.
[205] Millenium Services Group, ASX Announcement, 'Indicative Outcome of Elections for Scrip Consideration' (12 April 2024).
[206] Millenium Services Group, ASX Announcement, 'Scheme Booklet Registered with ASIC' (12 March 2024), p. 253.
[207] Ibid, p. 64.

Before Implementation



After Implementation



Based on the disclosures in the Scheme Booklet, there does not appear to have been any stated reason for Terence Yap to hold one Class C share at the incorporation of HoldCo. As a result of the single Class C share held outside the SoftBank Group, however, HoldCo technically qualified as an 'ultimate holding company' for the purposes of s 124-780(7) (as it was not a '100% subsidiary' of any other company in the group), such that eligible shareholders could obtain roll-over under Subdivision 124-M in relation to the disposal of their Millennium shares. This position seems to have been accepted in the ATO class ruling.

5.3 Anticipated ATO guidance on back-to-back CGT roll-overs

'Back-to-back' roll-overs generally describe a taxpayer using a series or 'chain' of CGT roll-overs in sequence.

In the context of M&A, this may be used by some taxpayers to restructure a business prior to sale. For example, a taxpayer may use a 'corporatising' roll-over[208] to restructure the assets of a business operated through a partnership or trust (or by an individual) into a wholly owned 'cleanskin' company in anticipation of an acquisition by a third party purchaser. If the consideration for the acquisition of the shares comprises scrip issued by the purchaser, the taxpayer may then seek to rely on scrip for scrip roll-over under Subdivision 124-M to defer any capital gain on disposal of shares in the cleanskin company until such time as the replacement shares are sold.

The ATO initially flagged that certain back-to-back CGT roll-over transactions were an emerging area of concern in 2012:[209]

> *Back-to-back roll-overs - using external data sources, we are selecting higher risk cases for review where taxpayers are applying back-to-back CGT roll-overs to defer CGT.*

[208] For example, rollover under Subdivision 122-A (Disposal or creation of assets by an individual or trustee to a wholly-owned company) or Subdivision 122-B (Disposal or creation of assets by partners to a wholly-owned company).
[209] Losses and CGT Subcommittee minutes, 14 November 2012.

Despite this, the ATO has since issued favourable rulings on the use of back-to-back CGT roll-overs, for example:

- In **Class Ruling CR 2015/12** (Bailador Siteminder Co-Investment Trust), Bailador proposed to create a listed company – Bailador Technology Investments Limited (**BTIL**) – to hold the investments owned by certain unit trusts, with BTIL's ordinary shares to be listed on the ASX. The restructure involved a two-step process: first, each unit holder transferred their units to a newly incorporated wholly-owned acquiring company; and second, each acquiring company's sole shareholder then transferred their shares in the acquiring company to BTIL in exchange for BTIL shares. According to the Class Ruling, the conditions for roll-over under Subdivision 122-A were satisfied in relation to the disposal by unit holders of their units to their respective acquiring companies (each being a company wholly owned by the relevant unit holder just after the disposal). The Class Ruling also confirmed that a shareholder who would otherwise make a capital gain from the disposal of their shares in an acquiring company to BTIL was eligible to choose a CGT roll-over under Subdivision 124-M.

- In **Private Ruling Authorisation Number: 1012885744181**, three siblings (and their associated entities forming a Family Group) operated multiple businesses through separate companies. Several businesses had previously been rolled up from partnerships into companies under Subdivision 122-B. The Family Group proposed to aggregate all businesses under a single holding company (one of the existing Family Group companies) via six simultaneous scrip-for-scrip exchanges, to facilitate investment by an arm's length investor and a prospective ASX listing. The businesses of several Family Group companies (Companies 3–8) were previously carried on by their shareholders in partnership. Each company acquired the business assets from its shareholders during the relevant income year by way of a CGT roll-over under Subdivision 122-B. (Note: the ruling did not specifically rule on the correctness of the Subdivision 122-B roll-overs). The holding company (one of the Family Group companies) acquired all shares in Companies 3–8 in exchange for issuing its own shares to the relevant vendors. The ruling confirmed each vendor was eligible to choose a CGT roll-over under Subdivision 124-M in relation to each of the six simultaneous share exchanges. The ATO also confirmed in the ruling that Part IVA will not apply to the choice to claim a scrip-for-scrip roll-over under Subdivision 124-M.

In November 2018, the ATO formally announced it would be releasing draft guidance on back-to-back CGT roll-overs. The anticipated date for release of the draft guidance has since been delayed several times.

On 12 June 2026, the ATO indicated that it intended to publish – in the forthcoming week – a draft practical compliance guideline addressing 'lower' and 'higher' risk arrangements involving back-to-back CGT roll-overs, and the circumstances in which the ATO would be more likely to apply compliance resources to consider the application of Part IVA. This guidance was ultimately **not** published, and at the time of writing the anticipated date for completion remains 'Mid 2026'. [210]

Interestingly, the scope of the anticipated guidance appears to have changed over time. Whereas previous iterations referred to guidance being released on the application of the 'nothing else' condition (which features in several CGT roll-overs) to back-to-back roll-overs, the current formulation focuses solely on Part IVA:

> This draft Guideline will explain when we are more likely to apply compliance resources to consider the application of Part IVA of the Income Tax Assessment Act 1936 (the general anti-avoidance provisions of the income tax law) to an arrangement that comprises multiple CGT roll-overs.[211]

Several roll-overs contain a 'nothing else' condition which, although expressed differently across different Divisions, typically requires that the taxpayer exchanges their original asset for a replacement asset 'and

[210] ATO Website, 'Advice under development – capital gains tax issues' (last updated 3 August 2026).
[211] Ibid.

nothing else'. This includes roll-over under Subdivision 124-E (Exchange of shares or units), Subdivision 124-F (Exchange of rights or options), Subdivision 124-I (Change of incorporation), Subdivision 124-Q (Exchange of stapled ownership interests for ownership interests in a unit trust), Division 125 (Demerger relief) and Division 615 (Roll-overs for Business Restructures).

Further, several roll-overs – while not expressly containing a 'nothing else' condition – nonetheless restrict what the taxpayer 'receives' as a condition of the roll-over. For example, the 'corporatising' roll-overs in Subdivisions 122-A and 122-B require that the consideration for the relevant 'trigger event' giving rise to the roll-over (e.g. disposing of a business to a company) must be 'only' shares in the company.[212]

In the context of demerger tax relief, in short, the ATO has taken an increasingly restrictive view on the availability of demerger relief by, among other things, adopting a broad interpretation of the 'restructuring' (and the related 'nothing else') condition in s 125-70(1).[213]

The thrust of the ATO's views[214] is that 'restructuring' as used in s 125-70(1) is sufficiently broad to capture all transactions which occur under the broader plan for reorganising the demerger group, even if those transactions are "legally independent of each other, contingent on different events, or may not all occur".[215] As such, where another transaction – such as a third party acquisition or capital raising – forms part of the 'restructuring' (broadly defined) which includes the demerger, it is possible that the 'nothing else' or other conditions for demerger relief will not be satisfied.

While this view is not without criticism, and in our view incorrect, it is not inconceivable that the ATO would seek to apply similar logic to other CGT roll-overs undertaken sequentially where one of the roll-overs contains a 'nothing else' condition. Notably, however, a highly forensic approach to the nothing else condition, at least in a Division 615 context, has been rejected by the Federal Court of Australia in *AusNet*.

5.3.1 The *AusNet* decision

Background

AusNet concerned the restructure of a stapled group known as AusNet Services.

The stapled group consisted of two public companies, AusNet Services (Transmission) Ltd (**Transmission**) and AusNet Services (Distribution) Limited (**Distribution**), and a unit trust, AusNet Services Finance Trust (**Finance**). The units in Finance were stapled to the shares in Transmission and Distribution (each of which were head companies of separate tax consolidated groups), such that the securities could not be transferred or dealt with independently of each other. The triple-stapled securities were primarily listed on the ASX with a secondary listing on the Singapore Exchange.

Broadly, under a series of schemes of arrangement entered into in 2015:

1. the securities were unstapled;
2. a new shelf company (AusNet Services Ltd) (**TopCo**) was formed;

[212] ITAA 1997, ss 122-20(1), 122-130(1).
[213] See further, Joseph Power and Jay Prasad, 'Has the ATO created a demergency?' (October 2020) 24(2)*The Tax Specialist* 69.
[214] As expressed in Taxation Determination 2020/6, *Income tax: what is a 'restructuring' for the purposes of subsection 125-70(1) of the Income Tax Assessment Act 1997?* (**TD 2020/6**).
[215] TD 2020/6, [3].

3. TopCo acquired all of the shares in Transmission in exchange for shares in TopCo – an election was made to continue the Transmission tax consolidated group (**TCG**) in existence;
4. TopCo acquired all of the units in Finance in exchange for shares in TopCo;
5. TopCo acquired all of the shares in Distribution in exchange for shares in TopCo – Top Co became the new head company of the Distribution TCG; and
6. by resolution of TopCo's shareholders, all the shares in TopCo were converted to the same number of shares as the number of stapled securities on issue at the record date.

On 1 July 2015, the ATO issued a positive class ruling confirming that the conditions for Division 615 roll-over were met with respect to the disposal by securityholders of their interests in each of Transmission, Distribution and Finance in exchange for shares in TopCo.[216]

Key Issues

For the income years ended 31 March 2016 to 31 March 2020, TopCo prepared its income tax returns on the basis that Division 615 roll-over applied in connection with the acquisition of its shares in Distribution.

However, and despite the positive class ruling, TopCo then lodged objections to the notices of assessment for the relevant income years, taking the view that Division 615 roll-over was in fact *not* available in connection with the acquisition of the Distribution shares, the broader context being that Division 615 roll-over precluded a reset for TopCo in the tax cost of the assets formerly held by the Distribution TCG. The objections were denied.

Before Hespe J, the parties agreed that the resolution of two technical questions as to the requirements of Division 615 roll-over would be dispositive of the proceedings:

1. was there a scheme for reorganising the affairs of Distribution for the purposes of s 615-5(1)(c); and
2. were the ratios in s 615-20(2) equal?

For present purposes, this paper focuses on the first issue.

First instance

One argument made by TopCo was that the nothing else condition in s 615-5(1)(c) was not satisfied, as the former Distribution shareholders received not only shares in TopCo in exchange for their shares in Distribution, but also a 'boost' in the value of the TopCo shares which they already held by virtue of exchanging their shares and units for TopCo shares under the Transmission and Finance schemes (which occurred first in the overall sequence).

Hespe J was not convinced that this valuation argument could be made out at a factual level, noting the interdependent and inter-conditional nature of the three schemes:

> Because of the legal interdependence of the schemes, there is an air of unreality to the applicant's submission that immediately prior to the completion of the Distribution scheme, the Transmission and Finance schemes had transferred value to the applicant that was independent of the value of the Distribution. The reality was that all the value accrued to the applicant and in the shares issued by it at the same moment because either all the schemes were completed or none were. There was no moment in time when the applicant could reflect the value of

[216] CR 2015/45.

> Transmission and Finance and not also reflect the value of its obligation to acquire Distribution in exchange for the issue of shares.[217]

More broadly, her Honour considered that, as a matter of statutory interpretation, s 615-5(1)(c) focused attention on what shareholders received *in exchange for their shares*, rather than inviting a wide-ranging inquiry into the consequences of the scheme:

> As a matter of statutory interpretation, the requirement in s 615-5(1)(c) is that under a scheme for reorganising the affairs of Distribution, the exchanging members (being the existing owners of the shares in Distribution) dispose of their shares in Distribution "in exchange for" shares in the applicant "and nothing else". By its terms, s 615-5(1)(c) focusses on that which a shareholder receives under the scheme in exchange for the shares. It does not look to the consequences of the scheme, but rather the consideration or quid pro quo received for the disposal of the shares.
>
> Clause 6.1(a) of the Distribution scheme of arrangement provided:
>
>> In consideration for the transfer of Distribution Shares under clause 5.4(a), each Eligible Securityholder will be entitled to receive 1 [applicant] Share for every 1 Distribution Share transferred under the Scheme.
>
> Under the terms of the Distribution scheme of arrangement, the Distribution shareholders received one share in the applicant in exchange for the disposal of each Distribution share and "nothing else".[218]

On appeal, the decision of Hespe J was affirmed by the majority

In separate judgments, Logan and Kennett JJ (Thawley J agreeing with Kennett J) both expressly agreed with Hespe J's construction on the nothing else condition:

> However, read in context, the focus of this provision is just on the consideration for the exchange. The intention of the parenthetical qualification "and nothing else" is to confine the application of this criterion just to an exchange where shares in the interposed company, as opposed to additional consideration, are received. It does not look to incidental consequences of the "exchange".[219]
>
> …
>
> The first issue that requires attention is whether any "boost" to the value of shares that the Distribution shareholders already held in Ausnet is relevant to the scheme satisfying the requirements of s 615–5(1)(c). The provision, it will be recalled, refers to a disposal of shares "in exchange for shares in the interposed company (and nothing else)". The critical integer, therefore, is what the shareholder receives "in exchange" for their shares or units in the original entity. **That language directs attention to consideration in the traditional contractual sense: it is concerned with what tangible benefits pass from the acquirer of the shares or units (the interposed company) to the person disposing of those shares or units. It does not invite a more general inquiry into the consequences of the transaction.**[220]

Special leave to appeal the decision of the Full Federal Court was refused on 7 August 2025.[221]

Interestingly, the parties in *AusNet* proceeded on the basis that the Distribution scheme was a standalone scheme to which Division 615 could apply, despite being one aspect of an inter-conditional scheme of arrangement.[222]

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217 *AusNet Services Ltd v Commissioner of Taxation* [2024] FCA 90, [101].
218 Ibid, [103]-[104].
219 *AusNet*, [46].
220 Ibid, [160].
221 *AusNet Services Ltd v Commissioner of Taxation* [2025] HCADisp 166.
222 *AusNet*, [89].

In the context of Division 615, the ATO has taken different approaches to this issue in the past. For example, in the merger of Afterpay Holdings Limited (**Afterpay**) and Touchcorp Limited (**Touchcorp**), the ATO accepted that the acquisition of Touchcorp by Afterpay Touch Group (**NewCo**) qualified for Division 615 roll-over (see CR 2017/48), and that the acquisition of Afterpay by NewCo – which immediately followed on the same day – qualified for Subdivision 124-M roll-over (see CR 2017/49). In other words, the ATO accepted that the initial Touchcorp scheme was a separate scheme to which Division 615 could apply. A few years later, in the merger of Allkem Limited (**Allkem**) and Livent Corporation (**Livent**), Arcadium Lithium plc was formed to first acquire Allkem and immediately after to acquire Livent.[223] The ATO ruled that Subdivision 124-M roll-over was available for Allkem shareholders, implying that Division 615 roll-over was **not** available.[224] Accordingly, for similar transaction structures, the ATO allowed Division 615 roll-over in one case but not in another.

More generally, although the drafting and policy context of Division 615 is distinct from Division 125 (and other roll-overs which contain a nothing else condition), the *AusNet* decision (while technically a victory for the Commissioner) may be thought to be inconsistent with the approach to demerger relief expressed in TD 2020/6 and, as such, may to some extent explain why the scope of the ATO's anticipated guidance on back-to-back roll-overs has shifted from the nothing else condition to Part IVA of the ITAA 1936.

5.4 Board of Tax Review of CGT roll-overs

For completeness, the Board of Taxation conducted a review of the CGT roll-over rules and released a Consultation Paper in December 2020. The Board provided interim written advice to the Government on 25 March 2021.[225]

In the Consultation Paper, the Board of Taxation proposed a general roll-over for 'business restructuring' intended to replace the existing suite of transaction-based restructure roll-overs. In particular, the proposed general business restructure roll-over would incorporate and replace two broad categories of roll-overs:

- **Underlying assets-for-scrip**: roll-overs that apply when business assets are transferred to a company and the underlying ownership of the assets are maintained, such as Subdivisions 122-A, 122-B, 124-N and 126-B.

- **Scrip-for-scrip**: roll-overs that apply when scrip is exchanged for scrip resulting in new legal owner(s) holding at least 80% of an entity. The economic ownership of the underlying assets may not need to be maintained in certain circumstances. Roll-overs in this category include Divisions 125, 615 and Subdivision 124-M.

Under the proposed general business restructure roll-over, CGT roll-over relief would be available for CGT events occurring in connection with a collection of transactions that constitute a single 'restructure' scheme.

Relevantly, in the context of back-to-back roll-overs, the Board noted that this approach would eliminate the need to engage in restructures under successive steps and would be particularly relevant for small and medium business entities, alleviating “the perennial problem of running the Part IVA gauntlet” with respect to back-to-back roll-over transactions.[226]

Unfortunately, the Board of Taxation’s proposal has (to date) not been implemented by the Government.

[223] See Section 7.2 (Merger Conditions), Transaction Agreement between Allkem Limited, Lightning-A Limited (New TopCo) and Livent Corporation dated 10 May 2023.
[224] ITAA 1997, s 124-795(3).
[225] Board of Taxation, ‘Review of CGT Roll-overs – Consultation Paper’ (December 2020).
[226] Ibid p. 32.