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APPENDIX A

SUBMISSION TO SENATE ECONOMICS LEGISLATION COMMITTEE
SUBDIVISION 112-E (DEEMED SALE AND DEFERRED GAIN REGIME)

A. EXECUTIVE SUMMARY

We appreciate the opportunity to comment on the proposed amendments in Subdivision 112-E of the *Income Tax Assessment Act 1997*. While we acknowledge the policy objective of separating pre- and post-1 July 2027 gains, the current proposal is unduly complex, difficult to administer, and inconsistent with established CGT principles. The proposal relies on a deemed disposal, deferred recognition of gains and losses, and a subsequent apportionment process. These features introduce artificial constructs that will significantly increase compliance burden, create uncertainty and give rise to numerous unforeseen adverse outcomes.

The application of a deemed sale to every single asset owned by a resident individual or trust (and certain pre-CGT assets of companies) affects trillions of dollars of assets. The potential implications adopting this mechanism cannot be overstated.

We believe that no ordinary individual would be able to comprehend the complexity of the amendments without costly tax advice. This policy choice is entirely inconsistent with the red-tape reduction review currently being undertaken by the Government.

We consider that the same policy outcome can be achieved through a materially simpler and more coherent framework based on asset tagging and gain apportionment, as outlined in Section C. We believe that the system could become unsustainable under the proposal and strongly request consideration of this alternative approach.

To the extent that this alternative approach is not accepted, we strongly recommend that you consider technical amendments contained in Section D that may reduce some of the unintended consequences that may occur under the proposed amendments.

Finally, Section E sets out our overarching comment that the Bill, in its current form, is creating a rule that will require endless amendments, ATO rulings and Treasury time and resources to manage the interaction and interpretive issues that will arise as a result of the deemed sale mechanism adopted. It is imperative that the design be reconsidered entirely and reworked in a way that achieves the same CGT outcomes, but in a way that does not trigger deemed sales for every asset held by an individual or trust.

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B. PROBLEMS WITH THE CURRENT DESIGN

Overview of the Current Proposal

Under the current proposal, taxpayers are taken to have disposed of CGT assets just before 1 July 2027 and to have reacquired them immediately after. Any resulting capital gain or loss is disregarded at that time and deferred until a later realisation event. At the time of that later disposal, the deferred amount is brought to account alongside the actual gain or loss arising on the transaction. The proposal also contemplates that the methodology for apportioning gains and losses between the deemed event and the realisation event may be determined by legislative instrument. The result is a layered framework that combines an artificial CGT event, deferred recognition rules, and externally determined apportionment methodologies.

Core issue, Unresolved Interactions Across the CGT Regime

One of the core issues with the current proposal is that it introduces a design with significant interactions that have not been properly worked through. CGT is a foundational element of the tax system and touches virtually every asset, transaction type, and taxpayer group. The proposed framework does not operate in isolation and interacts directly with loss utilisation rules, discount capital gains, indexation, trust attribution, and a range of integrity and ordering provisions. The proposals require every single asset to be disposed of and re-acquired as at 30 June 2027.

We have set out in Appendix A an initial list of interaction issues identified through a preliminary review of the provisions. This list has been generated by having worked through the provisions over a short period of time. We note that once the legislation is fully implemented, we would expect this list to grow substantially in size. This will place a significant amount of pressure on making amendments to the law to correct these issues.

Accordingly, once those interactions are properly considered, the practical operation of the regime will become substantially more complex than the drafting suggests and will lead to unintended consequences the extent of which that cannot be foreseen. We consider that as these interactions are examined more closely, it will become abundantly clear that the current policy choice creates a framework that is fundamentally complex and difficult to sustain in practice.

Artificial CGT Event

The proposal introduces a deemed disposal that does not correspond to any real economic transaction. This represents a departure from the core CGT design, which is based on taxing gains on realisation. In many cases, the notional gain may not reflect any underlying economic gain.

For example, if a taxpayer owns pre-CGT shares with underlying post-CGT assets, the method requires a capital gain to be calculated and deferred under CGT event K6. However, in most cases, those assets are sold at the company level and the gains are paid out as a dividend on liquidation, meaning no capital gain would generally arise. Under the proposed method, the

deferred gain will still be taxed, potentially resulting in double taxation where a capital loss is not recognised.

The choice of a deemed sale mechanism creates potential distortions and unintended consequences because it deems a sale, together with a capital gain or loss, that may never actually happen. This issue is exacerbated in multi-tiered structures, where gains or losses can be replicated across a chain of entities, giving rise to multiple layers of taxation for the same underlying economic gain. While these amounts may be expected to reverse through cost base adjustments, this is not clear given the tax integrity rules that may apply. In any case, the deemed event creates a notional outcome that must later be traced and reconciled when a real transaction occurs, adding unnecessary structural complexity.

Ambiguity as to when the realisation event occurs

A further concern is that the deferred gain or loss is brought to account when a later 'realisation event' occurs. The provisions define this broadly as any CGT event (other than limited exclusions), which creates significant ambiguity as to when the taxing point arises. For example, CGT event H2 can apply to any act relating to asset, irrespective of whether proceeds are received.

The complexity of this issue is illustrated through Taxation Ruling TR 1999/19, which shows that a common transaction like a forfeited deposit on a property can potentially involve multiple CGT events and different assets (being the contractual rights, the right to sue or the underlying property asset). Under the proposed rule, this uncertainty can create a risk that the full deferred gain is brought to account even where the underlying asset has not been disposed of.

Departure from Established CGT Design

The structure of the proposal departs from established CGT principles. Transitional issues in the CGT regime have historically been addressed through valuation or time-based apportionment at the point of realisation. The current proposal instead adopts a deemed disposal and deferral model, which introduces unnecessary complexity and sits outside the standard design of the regime.

C. PROPOSED ALTERNATIVE APPROACH

Core rule

We believe that the deemed acquisition and disposal rule should be limited to pre-CGT assets only. For post-CGT assets that are pre-1 July 2027 assets, we recommend replacing Subdivision 112-E with a framework based on asset tagging and gain apportionment.

Under this approach, CGT assets held on 30 June 2027 by individuals and trusts would be tagged as '**tagged discount assets'**. No deemed disposal or reacquisition would occur, and no

notional gain or loss would be calculated or deferred. We are recommending that the approach only be required where the asset is sold for an ultimate capital gain at the end.

When a tagged discount asset is then subsequently disposed of, any capital gain would be apportioned between a pre-1 July 2027 component and a post-1 July 2027 component. The method of apportionment could remain consistent with the current legislative framework, allowing taxpayers to choose between a market value basis and a calculable deemed value. This achieves the policy objective without introducing artificial CGT events or deferred recognition mechanics.

We note that our proposed alternative should not result in an outcome that would reduce the tax revenue. As the alternative method of valuing CGT assets would be offered, it would mean that approximately the same outcome should occur under this alternative.

Apportionment Methods

Market value method

Taxpayers should be permitted to choose between two apportionment methods. The first method would be based on valuation, with the taxpayer determining the market value of the asset as at 30 June 2027. The gain up to that date would form the discount component, and that value would become the starting point for calculating the post-2027 gain, including indexation.

Alternative method

As contained in the current Bill, an alternative method could be provided. We have simply embedded a time apportionment method, however it is possible to retain the existing legislative instrument approach. Under our approach, a total capital gain could be calculated on disposal and then apportioned on a days held basis between pre- and post-1 July 2027 periods. The gain would be first calculated without indexation. Similar to the market value method, the discount component would be calculated first, and that value would become the starting point for calculating the post-2027 gain, including indexation. This alternative method is provided just for simplicity and as mentioned the current proposed alternative could be used instead.

Draft legislation

Although we have no experience in drafting legislation, we have included the alternative method in Appendix C in a format similar to the legislative package provided. We have provided this to demonstrate that we believe it should be relatively simpler to codify this proposed alternative.

Advantages of the Proposed Approach

The proposed approach removes the need for an artificial CGT event and ensures that tax outcomes are based on real transactions. It eliminates the deferred gain and loss framework, reducing duplication and simplifying compliance. It allows existing loss rules to operate in the ordinary way without the need for additional categories or ordering rules. It provides certainty by

embedding clear apportionment methods in the legislation. It also aligns with established CGT design and avoids introducing a complex and unfamiliar structure.

Conclusion

While the policy objective is understood, the current proposal creates a framework that is unnecessarily complex and interacts with the broader CGT regime in ways that have not been fully resolved. Given the pervasive role of CGT across the tax system, these interactions will amplify the complexity of the proposal in practice. Once fully considered, it is likely to become clear that the current design is not sustainable. A simpler model based on asset tagging and gain apportionment would achieve the same outcome in a more coherent, transparent and administratively workable manner. This approach also can support the proposed framework of splitting the gain into a residual and non-resident component. We therefore recommend that Subdivision 112-E be replaced with this alternative proposed approach.

D. AMENDMENTS TO ADDRESS SOME OF THESE CONCERNS

If the alternative approach is not accepted, we strongly recommend that the committee recommends the addition of supporting provisions that address these significant concerns. These items include:

1. A provision that ensures that the ‘in relation to the CGT asset’ test (as contained in proposed sections 112-260(3) and 112-270(3)) is limited to an appropriate CGT event happening and not just any event that has some connection with the asset.

2. The ‘deemed sale’ rule is instead replaced with a ‘deemed event’ rule that results in a CGT event happening just before 1 July 2027 of the same kind that happens when the realisation event happens and in same circumstances as the as the ultimate realisation event. For example, if CGT event C2 happens in a future time for which the proceeds are otherwise assessable, then the deemed event just before 1 July 2027 is also taken to be CGT event C2 in the circumstances of receiving an assessable payment. This can help to ensure that rules (such as section 118-20) can be properly linked on the final transaction.

3. If there is a part disposal of an asset, that the realisation event also happens in relation to the appropriate part amount of the deferred notional gain or loss. The current drafting requires 100% of the gain or loss to be recognised if only 1% of the asset is disposed of.

4. An appropriate anti-duplication rule is included to, as the current rule (contained in section 118-20) does not appropriately deal with double taxation under the new event given it cannot create reduce capital proceeds in order to create a capital loss to offset the deferred gain. For example, a deferred gain on shares may be calculated on amounts that are later paid as assessable dividends. To the extent that the taxpayer has received other assessable amounts (outside of CGT), section 118-20 (or another provision) should apply to reduce the notional deferred gain (as well as the later gain that happens) by the assessable amount.

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E. INTERACTION ISSUES THAT WILL NEED TO BE ADDRESSED

In addition to the core items outlined above, we highlight the following initial interaction issues identified based on our limited analysis of the current Bill. As the regime is applied in practice, we expect the volume and complexity of these interactions to increase significantly under the proposed Subdivision 112-E framework. We believe that this will create an ongoing onus on Treasury to deal with interaction issues that is akin to the tax consolidation provisions, as well as requiring numerous rulings and guidance products to be developed by the ATO. Rather than going down this path, we believe our alternative approach that does not trigger a deemed sale or CGT event just before 1 July 2027 will remove these issues arising in their entirety.

The following is only a small subset of such interaction issues that have been identified so far:

- Treatment of collectables – Given the provisions result in a deemed sale of all assets, we believe that this will unintentionally bring 'collectables' with a cost base of less than $500 into the system (i.e. if the market value at 1 July 2027 is greater than $500). Section 118-10 will exclude the deferred gain but may give rise to a capital loss on the ultimate disposal of the collectable which would have otherwise always been excluded.

- Personal use assets – The deemed reacquisition provisions may reset the $10,000 threshold, which may result in subsequent taxable gains that would have otherwise always been disregarded.

- Breadth of CGT event H2 – CGT event H2 can apply when there is any act 'in relation to' a CGT asset'. This can inadvertently result in a crystallising of all deferred gains from 1 July 2027.

- Events on death – It is unclear whether Division 128 disregards deferred gains. Our reading is that there is no deferral, resulting in a realisation event at that time. Accordingly, death could give rise to a realisation of all deferred gains and losses with no roll-over. If Division 128 does disregard a deferred gain, there is no obvious mechanism to tax this at a later time in the hands of the deceased estate or the beneficiary to whom the asset passes.

- Subsequent CGT roll-overs – CGT roll-overs are provided for certain events happening in relation to CGT assets. However, the provisions in the Bill do not cater for a deferred gain or loss on assets that are subject to subsequent CGT roll-over upon a realisation event happening. Accordingly, CGT roll-overs on assets with deferred gains or losses may crystallise deferred gains prematurely, preventing continued deferral.

- Partial realisations – The drafting appears to bring to account 100% of a gain or loss even if there is only a portion of the CGT asset ultimately disposed of.

- Asset splits/mergers – There is no guidance on how to treat an asset split/merger under section 112-25 when there is a deferred gain or loss on the relevant asset. As the event

is not a CGT event, the deferred gain or loss needs to follow the relevant split or merged asset. However, the provision does not cater for this.

- Double taxation risks – Section 118-20 is not broad enough to cover double taxation that may occur with the realisation of a deferred gain (which is ultimately realised through a different method, e.g,, dividends, revenue account, etc). For example, if a property is acquired on revenue account, Subdivision 112-E would still apply to the relevant CGT asset. On a subsequent disposal, the deferred gain would need to be reduced by the revenue gain. Section 118-20 is not broad enough to accomplish this. Furthermore, the subsequent disposal may result in a revenue loss. The provisions cannot deal with this scenario appropriately.

- No cost base assets – There are assets that may have no cost base that rely on section 118-20 to prevent double taxation. For example, service receivables (see ATO ID 2005/211 (withdrawn)). We are concerned that the deferred gain or loss provision will not interact with section 118-20 when the ultimate asset is realised. For example, simply collecting the amounts due under a service receivable results in double taxation.

- Rights (employment, earnouts, litigation) – The term CGT assets covers a broad range of items. For example, a worker that has accrued leave/wages on their employment contract may have a valuable CGT asset (being the contract). The provisions technically require a deemed sale and disposal of all of these assets, even though the contract should not give rise to CGT consequences when terminated. The current drafting may mandate a requirement to consider these types of issues.

- Loans with accrued interest – Such assets are still CGT asset resulting in a deferred gain. This will need to properly interact with section 6-5, section 26BB, and TOFA under Division 230 to ensure that the deferred capital gain is not taxed twice.

- Pre-acquisition profits – Subsection 110-55(7) can deny a company capital losses on shares where dividends are received post-acquisition. As Subdivision 112-E may treat a company as having re-acquired any pre-CGT shares it holds on 1 July 2027, there is a risk that this provision may inappropriately treats all dividends received as pre-acquisition dividends, reducing the cost base under Subdivision 112-E. This can result in a duplication of the overall capital gain through the cost base reduction mechanism. Furthermore, this can give rise to complex issues when determining the outcome of CGT event K6.

- Companies with retained earnings – When the deferred gain crystallises, there may be no offsetting loss on liquidation. This is due to the ATO view in TD 2001/27 which outlines that capital losses do not occur. This results in taxation on the same gain twice (the deferred gain and the subsequent dividends under sections 44 and 47).

- Small business concessions (Div 152) – Shareholder may not qualify for concessions on the deferred gain even when the disposal of the company's assets meet all conditions. An interaction is required to ensure the capital gain retains its character.

- Multi-tier structures – Subdivision 112-E requires the deemed disposal to happen at every tier of ownership. However, on a liquidation of a structure, this would rarely give rise to a capital gain or loss on the intermediate tiers. We believe that this is likely to give rise to duplication of gains and losses throughout the system. Furthermore, while the cascading duplicated gains/losses will occur Subdivisions 165-CC/CD does not apply for small business entities or for trusts. This may create multiple duplications of losses throughout the system.

- Main residence – Under Subdivision 118-B, we believe that there will be complex interactions with 6-year absence rule where there is a deemed disposal and reacquisition.

- Non-resident discount rules – The interaction with section 115-105 and section 115-115 is unclear for post-2027 events.

- Consolidation treatment on formation – There may be deferred gains on membership interests when an entity joins consolidated group on formation of a group (non-acquisition case). The entity joining the group may be a unit trust. It is unclear what happens to the relevant asset that is being reset, or where the asset is used as part of the Step 1 ACA process for another entity.

Subdivision 112-E—Pre-CGT assets and tagged discount assets

Table of sections

112-250 Pre-CGT assets—deemed disposal and reacquisition on 1 July 2027
112-255 Tagged discount assets—assets held before 1 July 2027
112-260 Apportionment of capital gains for tagged discount assets
112-265 Market value method for working out the value
112-270 Days basis method for working out the value

112-250 Pre-CGT assets—deemed disposal and reacquisition on 1 July 2027

Application

(1) This section applies in relation to a *CGT asset if:
(a) the asset is a *pre-CGT asset on 30 June 2027; and
(b) the asset is held by the entity just before 1 July 2027.

Deemed disposal and reacquisition

(2) For the purposes of this Part, Part 3-3 and Subdivision 960-M, the entity is taken:
(a) to have disposed of the asset just before 1 July 2027; and
(b) to have acquired the asset again just after that time.

(3) The *capital proceeds from the disposal are taken to be equal to the value of the asset worked out under:
(a) if the entity chooses the market value method—section 112-265; or
(b) otherwise—section 112-270.

Effect of deemed disposal

(4) Any *capital gain or *capital loss arising from the disposal is disregarded.

(5) The first element of the *cost base and *reduced cost base of the asset is taken to be an amount equal to those capital proceeds.

112-255 Tagged discount assets—assets held before 1 July 2027

Application

(1) This section applies in relation to a *CGT asset if:
(a) the asset was acquired by the entity before 1 July 2027; and
(b) the entity is an individual or a trust.

Note: In applying this section, a *CGT asset to which section 112-250 applies is taken to have been acquired on 1 July 2027.

Tagged discount asset

(2) A *CGT asset to which this section applies is a *tagged discount asset.

Modification for capital gains

(3) If this section applies, then this Act applies on the basis that any *capital gain from a *CGT event in relation to a *tagged discount asset on or after 1 July 2027 must be worked out under section 112-260.

(4) No *CGT event is taken to have occurred in relation to a *tagged discount asset on 30 June 2027 merely because this section applies.

112-260 Apportionment of capital gains for tagged discount assets

Application

(1) This section applies

(a) if a *CGT event happens on or after 1 July 2027 in relation to a *tagged discount asset; and

(b) disregarding Division 114 and Division 115, the CGT event results in a *capital gain in relation to the tagged discount asset (***overall capital gain***).

Note: This provision does not apply if you would make a capital loss on the tagged discount asset.

(2) The overall capital gain is split so that there are two capital gains (including a nil amount), each from the CGT event.

Note 1: The amount of the discount capital gain or the indexed capital gain may be nil. However, neither amount can result in a capital loss.

Note 2: If there is a disposal of property, CGT event A1 happens in respect of both capital gains.

(3) First, work out the overall capital gain.

(4) Next, work out the value of the asset on 30 June 2027:

(a) if the entity chooses the market value method—section 112-265; or

(b) otherwise—section 112-270.

Pre-1 July 2027 gain

(5) The pre-1 July 2027 gain is the amount by which that value exceeds the cost base under subsection (3), but not below nil.

Post-1 July 2027 gain

(6) The post-1 July 2027 gain is worked out as if:

(a) the asset were acquired on 1 July 2027 for that value; and

(b) that value formed the first element of cost base; and

(c) indexation applied under Division 114 and Subdivision 960-M.

Capping the amount

(7) If either the amount calculated under subsection (6) or (7) is greater than the overall capital gain, then reduce the relevant amount so that it is equal to the overall capital gain.

Apportionment

(8) To the extent that the CGT event relates to a part of a CGT asset, apply this section to the relevant part of the CGT asset.

Choice

(9) A choice under subsection (4) is made in accordance with section 103-25.

Note 1: Example: Market value method: An individual acquires a *tagged discount asset for $100 on 1 April 2024 and disposes of it for $250 on 1 July 2029. The gross capital gain is $150. The asset's value just before 1 July 2027 is $200, giving a pre-1 July 2027 gain of $100. Assuming that the indexed cost base is equal to $216.32, this results in a post-1 July 2027 gain of $33.68. The total capital gain is $133.68 comprising a discount component of $100 and an indexed component of $33.68.

Note 2: Example: Days basis method: Assume the same facts. The total ownership period is 1,917 days, of which 1,186 occur before 1 July 2027. The pre-1 July 2027 gain is $92.80, giving a value of $192.80. Assuming that the indexed cost base is equal to $208.53, this results in a post-1 July 2027 gain of $41.47. The total capital gain is $134.27 comprising a discount component of $92.80 and an indexed component of $41.47.

Note 3: Example: Assuming that only 50% of the asset is disposed of, the capital gain would be calculated having regard to 50% of the CGT asset.

112-265 Market value method for working out the value

(1) This section applies if the entity chooses this method.

(2) The value of the asset is its *market value just before the relevant time.

(3) If that value is less than cost base, use cost base.

112-270 Days basis method for working out the value

(1) This section applies if section 112-265 is not chosen.

(2) The value of the asset is worked out as:

cost base + gross capital gain × pre-1 July 2027 days ÷ total ownership days

where:

gross capital gain means:

(a) for section 112-260—the amount worked out under subsection 112-260(3); and

(b) for section 112-250—the amount that would arise if the asset were disposed of just before 1 July 2027 for its market value.

pre-1 July 2027 days means the number of days between acquisition and 30 June 2027.

total ownership days means:

(a) for section 112-260—the number of days between acquisition and the CGT event; and

(b) for section 112-250—the number of days between acquisition and 30 June 2027.

(3) For the purpose of this calculation, treat a part day as a whole day.

Subsection 995-1(1)

Insert:

tagged discount asset has the meaning given by subsection 112-255(2).