Small Business CGT Concessions

April, 2021

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Agenda

Access Conditions

- Eligibility requirements.
- Requirements for:
  - Individuals
  - Companies/Trusts

The Small Business Concessions.

The CGT Small Business Cap.

Case Study.

Access Conditions

- **First access condition:**
  - Small Business Entity Test (first alternative); or
  - Maximum Net Asset Value Test (second alternative):
    - Connected Entity and Affiliate.
- **Second access condition:**
  - Active Asset Test.
- **Third access condition (for companies/trusts only):**
  - CGT Concession Stakeholder/Significant Individual Test.
  - Small Business Participation Percentage (SBPP).

Eligibility Requirements

The Small Business Entity Test

- Carried on a business in the current year (can be after the CGT event).
- AND one of the following:
  - Aggregated turnover in the previous year was <$2m (AUD).
  - Aggregated turnover in current year is estimated to be <$2m.
  - Actual aggregated turnover in the current year is <$2m.
- Aggregated turnover:
  - Taxpayer's annual turnover.
  - The annual turnover of connected entities which were affiliates of the taxpayer.

Maximum Net Asset Value Test

Alternative Access Condition

- Maximum Net Asset Value (MNAV) does not exceed $6m:
  - The taxpayer who owns the CGT asset;
  - *Entities connected* with the taxpayer; and
  - Affiliates and their connected entities.
- Assets included in the net CGT asset value are not restricted to business assets (unless specifically excluded).
- The assets of affiliates, or entities connected with affiliates, are included in the maximum net asset value test only if those assets are used, or held ready for use, in a business carried on by the taxpayer or an entity connected with the taxpayer.

Connected Entities

- Control – control percentage.
- For a Company/Partnership/Unit Trust:
  - 40% distribution of income (or capital); or
  - 40% of the voting power of the Company.
- Discretionary Trust:
  - Reasonably expected the Trustee acts in accordance with the wishes of the entity or affiliate (the "influence" test); or
  - 40% capital or income distribution (the "distributions" test).
- Tax Commissioner's Discretion:
  - *The Commissioner can determine control even where entity has <40%.*

Affiliates

- An affiliate is an individual or company that, in relation to their business affairs, acts or could reasonably be expected to act:
  - in accordance with your directions or wishes, or
  - in concert with you.
- A person is not your affiliate merely because of the nature of a business relationship you and the person share.
- Neither a spouse nor a child under the age of 18 years is automatically your affiliate.
- You must consider whether they are acting according to your directions or wishes, or in concert with you, in relation to their business affairs.

Example - Affiliates

- Matt and Sandy are husband and wife. Matt carries on a cleaning business with an annual turnover of $1.7 million while Sandy carries on a bakery business with an annual turnover of $1.8 million.
- They have nothing to do with each other's business. They have:
  - separate bank accounts for their businesses.
  - different business locations.
  - their own employees.
- Neither Matt nor Sandy controls the management of the other's business.
- Even though Matt and Sandy are married neither is an affiliate of the other because they:
  - do not act in concert with each other in respect of their businesses, and
  - neither acts according to the directions or wishes of the other.
- Therefore neither Matt nor Sandy has to include the annual turnover of the other's business in calculating the aggregated turnover of their own business.

Net Value of CGT Assets

- The net value of CGT assets of an entity is the amount worked out by:
  - *Sum of the market values of those assets, less any liabilities of the entity that are related to those assets.*
- Subtract liabilities related to CGT assets:
  - Loans.
  - Bank overdrafts, etc.
- Subtract provisions for Annual Leave, Long Service Leave, Unearned Income and tax liabilities.
- Not included in liabilities:
  - Pending lawsuits, expenses not yet due, potential damages, etc.

Example – Total Assets & Liabilities

Assets	$	$
Plant and Machinery	1,500,000	
Freehold Premises	3,500,000	
		5,000,000
Liabilities		
Mortgage on premises	2,000,000	
Provision for long service leave	500,000	
Provision for tax liabilities	200,000	
Pending lawsuit	100,000	
		2,800,000
Net Assets		**2,200,000**

Example – Net Value of CGT Assets

Assets	**$**	**$**
Plant and Machinery	1,500,000	
Freehold Premises	3,500,000	
		5,000,000
Liabilities		
Mortgage on premises	2,000,000	
Provision for long service leave	500,000	
Provision for tax liabilities	200,000	
Pending lawsuit	IGNORE	
		2,700,000
Net Assets		**2,300,000**

Net Value of CGT Assets

- Include certain interests in connected entities.
- If a partner in a partnership and the CGT event happens in relation to a taxpayers’ asset or an asset of the partnership (e.g. disposal of a partnership asset), the maximum net asset value test would include:
  - All the assets of the partnership connected with that taxpayer, excluding that taxpayer’s interest in the partnership; or
  - Only the taxpayer’s interest in the partnership if not connected with it – not the assets of the partnership as a whole.
- Entities that hold shares or trust interests would calculate their maximum net asset value in a similar way.

Assets Excluded from Net Value

- The following assets are excluded when working out the net value of CGT assets:
  - Assets being used solely for personal enjoyment, or those of an affiliate.
  - The family home to the extent it is being used for private purposes.
  - Superannuation assets.
  - Insurance policies, such as Life Insurance.

Example - Maximum Net Asset Value Test

- D'Marcus owns a $900,000 house.
- He has owned it for 10 years.
- For the first two years it had no income-producing use.
- In years 3 to 8, 25% of the house was used to produce income.
- Years 9 to 10, 50% of the house was used to produce income.
- What amount to include in MNAV Test?
- Percentage [(2/10 x 0%) + (6/10 x 25%) + (2/10 x 50%)] = 25%.
- Therefore $900,000 x 25% = $225,000 included in MNAV Test.

Second Access Condition - Active Asset Test

A CGT asset is an active asset if it is owned by the taxpayer and is:

- Used or held ready for use in a business carried on (whether alone or in partnership) by the taxpayer, their affiliate, spouse or child (under 18 years), or an entity connected with the taxpayer; or
- An intangible asset that is inherently connected with a business carried on (whether alone or in partnership) by the taxpayer, their affiliate, their spouse or child, or another entity that is connected with the taxpayer.

- An intangible active asset is an asset such as Goodwill, but does not include intellectual property.

Second Access Condition - Active Asset Test

- The active asset test is satisfied if:
  - you have owned the asset for 15 years or less and the asset was an active asset of yours for a total of at least half of the test period, or
  - you have owned the asset for more than 15 years and the asset was an active asset of yours for a total of at least 7 ½ years during the test period.
- The test period:
  - begins when the asset is acquired, and
  - ends at the earlier of:
    - the CGT event, and
    - if the business in question ceased in the 12 months before the CGT event (or such longer time as the Commissioner allows) – when the business ceased.
- The periods in which the asset is an active asset do not need to be continuous. However, they must add up to the minimum periods specified above, depending in the total period of ownership.
- The asset does not need to be an active asset just before the CGT event.

Example - Active Asset

- Ben carries on an ocean cruise business called North Sea Adventures.
- He purchased waterfront land on 1 January 1990 but used it initially for family holidays and not in the business.
- On 1 January 1994 Ben started using the land in the business for launching his boats and carrying out necessary repairs and maintenance.
- He continued to do so until 1 January 2005, when he leased the business to an unrelated party for another 3 years before selling it.

Does the land satisfy the Active Asset Test?

- Yes – because it was actively used in Ben's business for at least 7 ½ years, even though the period was not continuous and the property was not used in his business just before it was disposed.

Example - Active Asset

- Janet carried on a business at various customer on-site locations.
- She acquired some land with the intention of constructing premises in which to carry on her business.
- Soon after Janet acquired the land she was approached by another party that wanted to acquire the land and accordingly she sold the land and made a capital gain.
- Janet was only part-way through the construction of the premises at that time.
- In this situation, the land was not held ready for use by Janet in the course of carrying on her business at any time.
- It was not in a state of preparedness from which Janet could carry on her business.
- Accordingly, the land was not an active asset at any time.

Shares in a Company & Units in a Unit Trust

Where the asset is a share in a company or units in a unit trust:

- Company/trust assets must be 80% active assets.
- 80% can be made of:
  - Active assets.
  - Financial instruments inherently connected with the business.
  - Any cash the company holds that is inherently connected with the business.
- Must be an Australian resident company or Australian resident unit trust.

Example - Shares in a Company

Jack and Jill are the only shareholders of Hill Water Supplies Pty Ltd, an Australian resident company that carries on a water supply business.

The market value of the company's CGT assets are as follows:

• Business premises	$400,000
• Business goodwill	$100,000
• Trading stock	$100,000
• Plant	$300,000
• Investment property (not an active asset)	$100,000
• **TOTAL**	**$1,000,000**

The total market value of the company's active assets is $900,000 which is more than 80% of the total market value of all the company's assets. Jack and Jill's shares in the company are therefore active assets.

Certain Assets not Active Assets

The following CGT assets cannot be active assets:

- Shares in companies or interests in trusts, other than those that satisfy the 80% test.
- Financial instruments, such as bank accounts, loans, debentures, bonds, futures and other contracts and share options (unless they are inherently connected with a business, in which case they count towards the satisfaction of the 80% test).
- Assets whose main use is to derive interest, an annuity, rent, royalties or foreign exchange gains (unless the main use for deriving rent was only temporary or the asset is an intangible asset that the taxpayer has substantially developed or improved so that its market value has been substantially enhanced), and
- Shares and trusts interests in widely held entities unless held by a CGT Concession Stakeholder in the widely held entity.

Example - Certain Assets not Active Assets

Example

- Rachel owns five investment properties which she rents to tenants under lease agreements that grant exclusive possession. The lease terms vary from six months to two years.
- The properties are not active assets because they are only used by Rachel to derive rent. It is irrelevant whether Rachel's activities constitute a business.

Example

- Mike owns a motel (land and buildings) which he uses to carry on a motel business. The motel provides room cleaning, breakfast, laundry and other services as part of the business. Guests staying in the motel do not receive exclusive possession but simply have the right to occupy a room on certain conditions. The usual length of stay by guests is between one and seven nights.
- The motel would be an active asset because its main use is not to derive rent.

Third Access Condition - CGT Concession Stakeholder

- If the CGT asset is a *share in a company or an interest in a trust*, there must be a CGT Concession Stakeholder just before the CGT event.
- An individual is a CGT Concession Stakeholder of a company or trust if the individual is:
  - A 'Significant Individual' in the company or trust; or
  - A spouse of a Significant Individual in the company or trust, if the Spouse has a Small Business Participation Percentage in the company or trust that is greater than zero.
- Therefore it follows that:
  - A CGT Concession Stakeholder can only ever be an individual; and
  - Where the CGT Concession Stakeholder is the Spouse of a Significant Individual, that Spouse must have at least some minimal shareholding in the company or interest in the trust in order to qualify as a CGT Concession Stakeholder.

Significant Individual Test

- An individual is a Significant Individual in a company or trust if they have a Small Business Participation Percentage in the company or trust of at least 20%.
- The 20% can be made up of direct and indirect percentages.
- A company or trust satisfies the Significant Individual Test if it had at least one Significant Individual just before the CGT event.

Significant Individual Test - Companies

- A person's direct Small Business Participation Percentage in a company is the percentage of:
  - Voting power the person is entitled to exercise; or
  - Any dividend payment or capital distribution the person is entitled to receive.
- The participation percentage can be held directly or indirectly through one or more interposed entities.
- Where there is an interposed entity between CGT Concession Stakeholders and shares or units for which the concessions are being claimed, 90% Small Business Participation Percentage must be held by CGT Concession Stakeholders.

Significant Individual Test - Trusts

- Fixed Trust – a person's direct small business participation is the percentage of the income and capital of the trust that the person is beneficially entitled to receive.
- Discretionary Trust – a person's direct small business percentage in the trust is the percentage of distributions of income and capital the person is beneficially entitled to during the income year if the trust made a distribution of income or capital.
- If the trust does not make a distribution of income or capital during the income year it will not have a Significant Individual during that income year.

Example - CGT Concession Stakeholder

- There are 100 issued shares in Company X, all with equal voting, dividend and distribution rights.
- Jack owns 99 shares and his wife Jill owns one share.
- Jack is a Significant Individual in the Company.
- Jill is Jack's spouse and because she owns a share in the Company, she has a Small Business Participation Percentage in the Company of >0.
- Jack and Jill are both CGT Concession Stakeholders and may be entitled to the Small Business Concessions when they sell their shares.

Example - Significant Individual Test

- Company XX has the following:

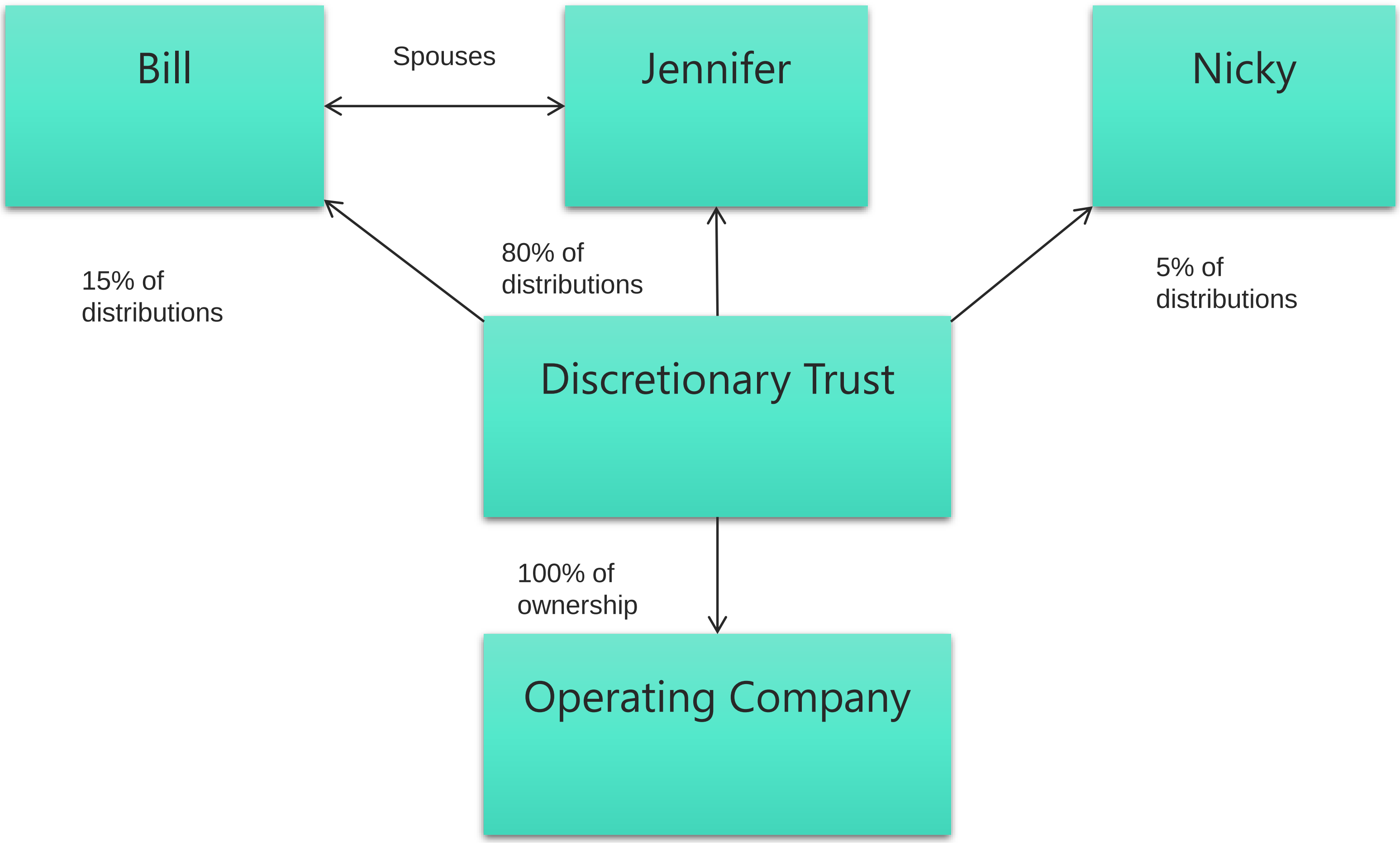
CGT stakeholder's interest		Spouse's interest	
Jack	20%	Jill	5%
Bob	20%	Jo	5%
Jen	20%	Bo	5%
Deb	20%	Jed	5%

- Jack, Bob, Jen and Deb are all Significant Individuals of Company XX as they satisfy the 20% test.
- Their spouses are also Concessional Stakeholders.
- All individuals would be able to take advantage of the CGT concessions.

The 90% Test

- The 90% test only applies if there is an interposed entity between the CGT Concession Stakeholders and the company or trust in which the shares or interests are held.
- The interposed entity satisfies the test if 90% of the participation percentage in that entity are held by CGT Concession Stakeholders.

Example - The 90% Test



Example - The 90% Test

- Jennifer receives 80% of the distribution from Discretionary Trust: therefore, she has a direct participation percentage of 80 per cent in Discretionary Trust.
- To find Jennifer's participation percentage in Operating Company, multiply together Jennifer's direct participation percentage in Discretionary Trust and Discretionary Trust's total participation in percentage in Operating Company (80% x 100% = 80%).
- Jennifer has an 80% participation percentage in Operating company and is therefore a significant individual of Operating Company.
- Bill receives 15% of the distribution from Discretionary Trust, therefore he has a direct participation percentage of 15% in Discretionary Trust.
- To find Bill's participation percentage in Operating Company, multiply together Bill's direct participation percentage in Discretionary Trust and Discretionary Trust's total participation percentage in Operating Company (15% x 100% = 15%).
- Bill has a 15% participation percentage in Operating Company and therefore not a Significant Individual of Operating Company.

Example - The 90% Test

- As a spouse of a significant individual with a participation percentage greater than zero in the entity, Bill will be a CGT Concession Stakeholder.
- Nicky receives 5% of the distribution from Discretionary Trust, therefore she has a direct participation percentage in Discretionary Trust.
- To find Nicky's participation percentage in Operating Company, multiply together Nicky's direct participation percentage in Discretionary Trust and Discretionary Trust's total participation percentage in Operating Company (5% x 100% = 5%).
- Nicky has a 5% participation percentage in Operating Company and is therefore not a significant individual of Operating Company.
- Nicky is not a CGT Concession Stakeholder.
- ***However Discretionary Trust satisfies the 90% Test because CGT Concession Stakeholders have a Small Business Participation Percentage of 95% in Operating Company.***

Changes effective 8 February 2018

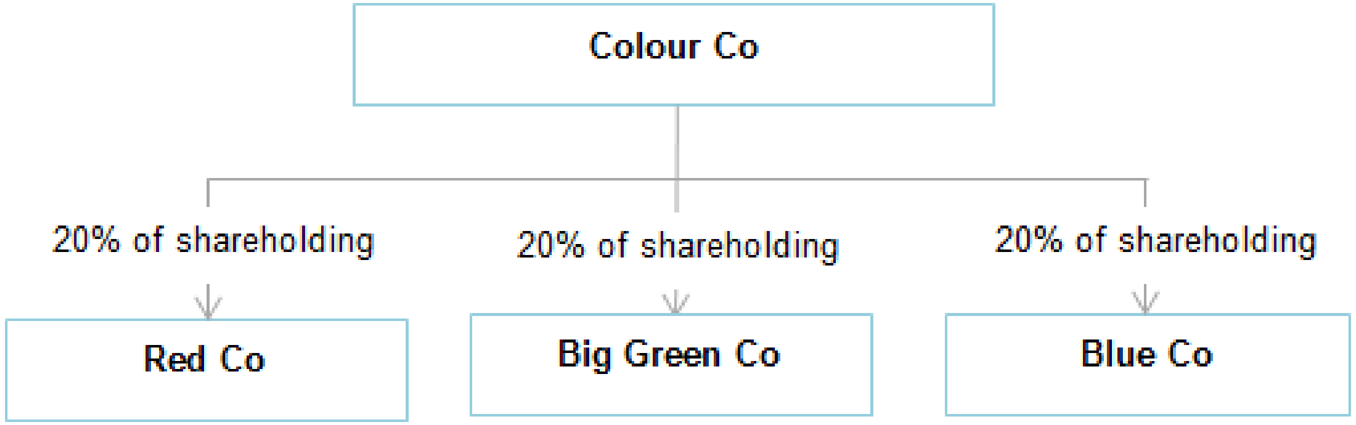
Super Concepts

- Those seeking the small business capital gains tax (CGT) concessions in the 2018 and later income years need to be wary of modified small business CGT concession integrity rules which apply from 8 February 2018
- Courtesy of Schedule 2 of the *Treasury Laws Amendment (Tax Integrity and Other Measures) Act 2018*.
- These are integrity rules designed to prevent taxpayers from accessing these concessions for assets which are unrelated to their small business.
- Such as by arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.

Modified connected entity rule

- Under the modified connected entity rule, the company or trust controls another entity if it has a control percentage of at least 20% or more in that other entity.
- Any Commissioner's determination that the entity does not control another entity (a control percentage of at least 40% but less than 50%) is disregarded for the modified connected entity rule.

Example - Modified connected entity rule

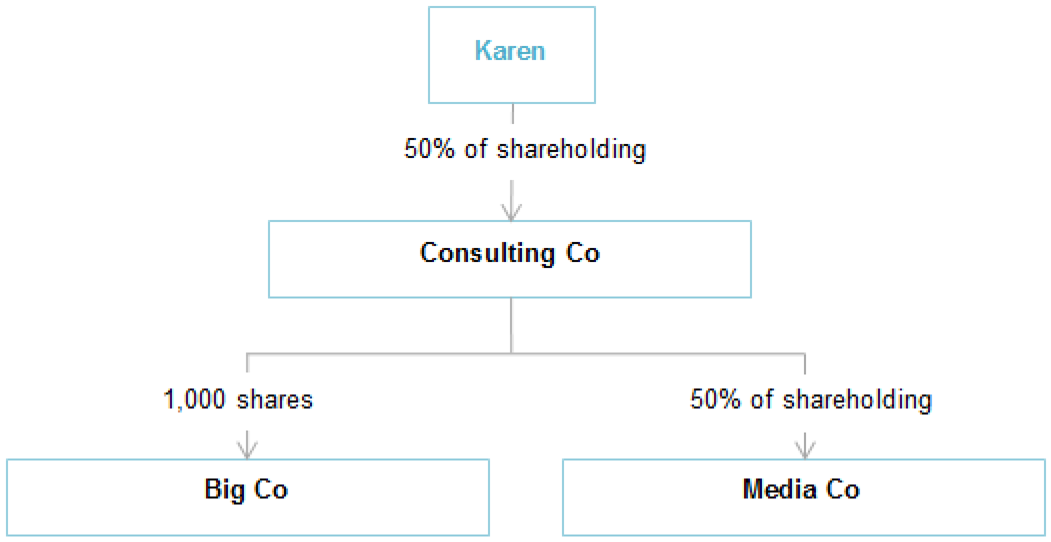


- Colour Co is a small business entity with an aggregated turnover of less than $2 million (when applying the general connected entity rule of which none of Red Co, Big Green Co and Blue Co would be connected with Colour Co as Colour Co holds less than 40% of shares in each of them).
- Big Green Co has an annual turnover of $5 million (from dealings unrelated to Colour Co) and the net value of its assets is $20 million.

Modified connected entity rule

- To determine whether Colour Co is a small business entity or satisfies the maximum net asset value test when applying the modified connected entity rule, Colour Co must include the annual turnovers and the net asset values of Red Co, Big Green Co and Blue Co as they are controlled by Colour Co (Colour Co owns 20% of the shares in each of them.).
- Given Big Green Co's annual turnover alone is $5 million, Colour Co would not be a small business entity with an aggregated turnover of less than $2 million.
- Colour Co also would not satisfy the maximum net asset value test as the total net value of the assets owned by Colour Co and entities controlled by it exceeds $6 million given the net value of Big Green Co's assets alone is $20 million.

Example - Modified active asset test



- Karen is a sole trader and is a small business entity with an aggregated turnover of less than $2 million (applying the general connected entity rule) for the 2018–19 income year.
- Karen owns 50% of the shares in Consulting Co, which is a small business entity with an aggregated turnover of less than $2 million (applying the modified connected entity rule) for the 2018–19 income year.

Example - Modified active asset test

- The total market value of Consulting Co's assets (excluding the value of shares in Big Co and Media Co) is $1 million, of which $980,000 is the value of its active assets.
- Consulting Co also owns 1,000 shares of the 10 million shares in Big Co.
- Consulting Co's small business participation percentage in Big Co is 0.01%.
- The total market value of Big Co's assets is $100 million.
- Consulting Co also owns 50% of Media Co, which is a small business entity with an aggregated turnover of less than $2 million.
- The total market value of Media Co's assets is $1.2 million, of which $1 million is the value of its active assets.

Example - Modified active asset test

- There are no significant amount of cash and financial instruments inherently connected to the business of Consulting Co and Media Co.
- There has been no significant change in the activities or holdings of Consulting Co, Big Co and Media Co over the period Karen has owned the shares.
- On 20 April 2019, Karen sells her shares in Consulting Co.
- The shares need to meet the modified active asset test for Karen to qualify for the small business CGT concessions.

Example - Modified active asset test

Step 1:

- The total market value of the assets in Consulting Co and other entities that Consulting Co has a small business participation percentage in (that is, Big Co and Media Co) is $1,610,000. This is the sum of the value of:
  - the Consulting Co's assets of $1 million
  - the Big Co's assets of $10,000 (calculated by multiplying the value of Big Co's assets by Consulting Co's participation percentage in it, that is, $100 million × 0.01%)
  - the Media Co's asset of $600,000 (calculated by multiplying the value of Media Co's asset by Consulting Co's participation percentage in it, that is, $1.2 million x 50%).

Example - Modified active asset test

Step 2:

- The market value of Consulting Co's active assets is $980,000.
- An asset of Media Co can only be an active asset for Consulting Co if Karen is a CGT concession stakeholder of Media Co.
- Karen's participation percentage is 25% in Media Co, calculated as:
    - 50% (Karen's participation percentage in Consulting Co), multiplied by 50% (Consulting Co's participation percentage in Media Co).
- As Karen's participation percentage in Media Co is at least 20%, the market value of Media Co's active assets of $500,000 is included in the Step 2 amount (calculated by multiplying the value of Media Co's active assets by Consulting Co's participation percentage in Media Co, that is, $1 million × 50%).
- Big Co's assets are not included in the Step 2 amount as Karen is not a CGT concession stakeholder of Big Co.
- The Step 2 amount is $1.48 million.

Example - Modified active asset test

Step 3:

- As the Step 2 amount is 92% of the Step 1 amount ($1.48 million ÷ $1.61 million) and noting there have been no significant changes to the activities or holdings of the relevant entities during the ownership period, Karen's shares meet the modified active asset test.
- If a taxpayer made a capital gain relating to shares in a company or an interest in a trust before 8 February 2018, there are fewer conditions they need to meet to be eligible.
- In this situation, a taxpayer must meet the basic conditions and just before the CGT event they must either:
    - be a CGT concession stakeholder in the company or trust
    - meet the 90% test.

The Small Business Concessions

- 15 year exemption
  - 100% capital gain exemption
- Small business 50% reduction
  - 50% capital gain exemption
- Small business retirement exemption
  - Capital gain exemption up to $500k
- Small business asset rollover
  - 100% capital gain deferred

15 Year Exemption

Super Concepts

- *No assessable capital gain on sale of an asset.*
- Basic conditions are satisfied and the entity continuously owned the asset for at least 15 years leading up to the CGT event.
- If the entity is an individual:
  - The individual is 55 or over at the time of the event and the event happens in connection with that person's retirement, or is permanently incapacitated at the time of the CGT event.
- If the entity is a company or trust:
  - The taxpayer must have a significant individual for periods totalling at least 15 years during which the entity owned the CGT asset (even if it was not always the same significant individual during the 15 years).
  - The individual who was the significant individual just before the CGT event must be over 55 and retired or is permanently incapacitated at the time of the CGT event.
- ***Up to $1.565 million may be contributed to super as a tax-free contribution ($1.615 million in 2021/22).***

Example - 15 Year Exemption

- Tarleigh, aged 63, sells a small business she has owned for 16 years.
- All the basic conditions are met.
- The cost base is $465,000.
- The sale proceeds are $1,865,000.
- Tarleigh intends retiring from the workforce.
- She is eligible to claim the 15 year exemption, which means the full capital gain of $1,400,000 plus proceeds totaling $165,000 can be contributed to superannuation.
- Assuming Tarleigh has not used any of the non-concessional contributions cap and is within the relevant TSB, the full $1,865,000 can be contributed to superannuation.
- $300,000 + $1,565,000 = $1,865,000.

Small Business 50% Reduction

- The small business 50% active asset reduction applies automatically if the basic conditions are satisfied, unless you choose for it not to apply.
- Consequences of applying the reduction:
    - If you satisfy the basic conditions, the capital gain that remains after applying any current year capital losses and any unapplied prior year net capital losses, and the CGT discount (if applicable), is reduced by 50%.
    - This means that if you are an individual or trust and you have applied the CGT discount and the small business 50% active asset reduction, the capital gain (after being reduced by any capital losses applied against it) is effectively reduced by 75% (that is, 50% then 50% of the remainder).

Retirement Exemption

- Can choose to disregard all or part of capital gain up to $500,000 lifetime limit.
- No need to retire, cease work or sell a business – the focus is not on retirement.
- If the CGT Concession Stakeholder is <55, they or the company/trust claiming the concession must make a payment equal to the exempt amount to super.
- Company/trust must have a Significant Individual.
- Exempt amount must be paid to a CGT Concession Stakeholder.
- Contribution is a tax-free contribution
- Counts against the lifetime cap ($1,565,000 as at 1 July 2019).

Example - Retirement Exemption

- Chanelle, 51, sells her business for $1.5 million.
- It has a cost base of $500,000 ($1 million capital gain).
- She can first apply the 50% general CGT discount, which leaves $500,000 gain.
- This can be further reduced by the Small Business 50% discount, leaving a $250,000 gain.
- Chanelle can then reduce the $250,000 capital gain to zero by using the retirement exemption.
- As she is under 55 the $250,000 must be contributed to super.
- It will count against her $500,000 lifetime cap AND the $1.565 million overall lifetime cap.
- But this means more of the gain is counted against the contributions cap/s.
- *Better to not use the Small Business 50% discount and use the $500,000 retirement exemption.*

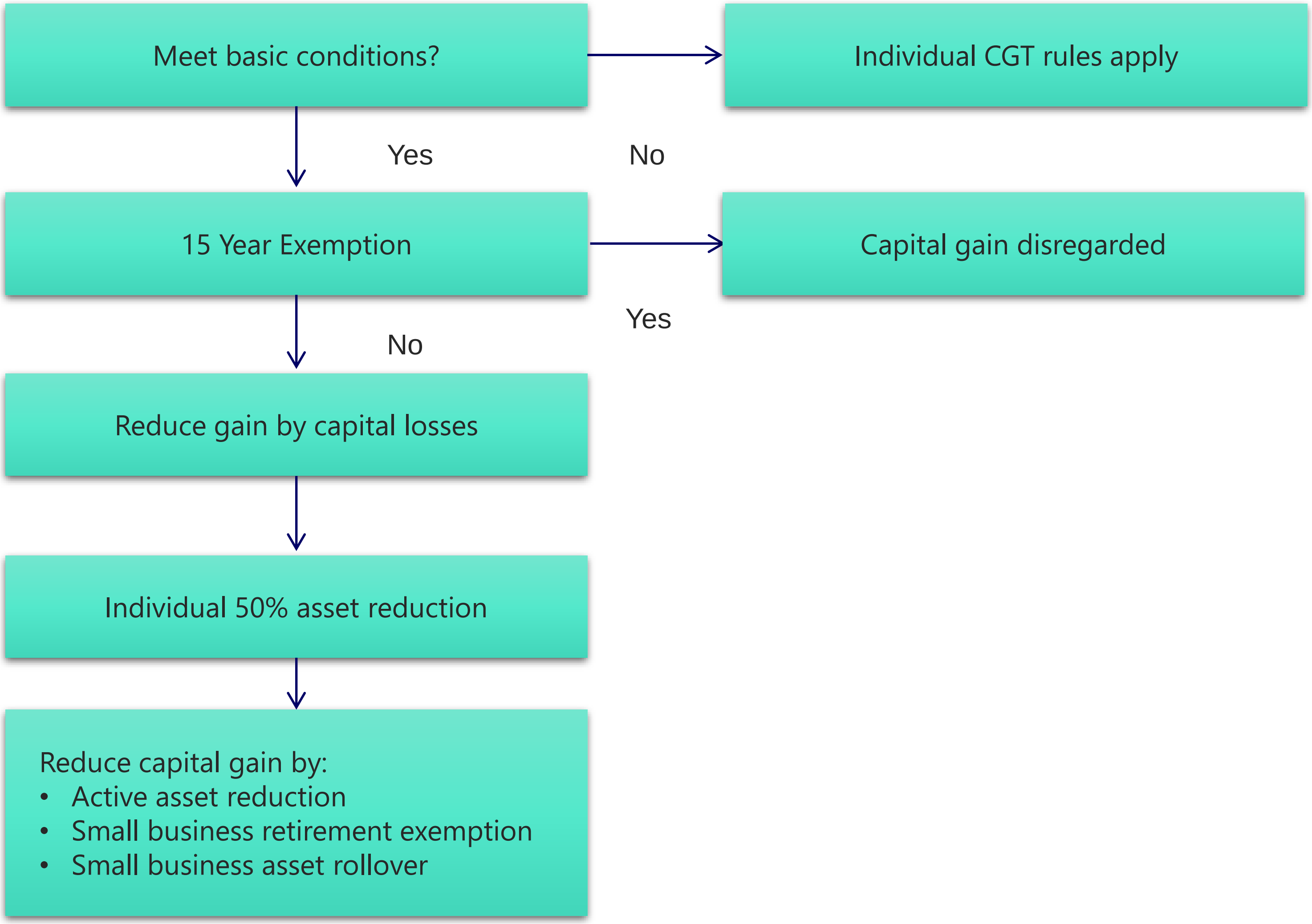
Small Business Rollover

- Allows a taxpayer to defer the making of a capital gain from a CGT event happening in relation to one or more small business assets.
- Basic conditions must be satisfied.
- For CGT events that happen in 2006/07 and later, the taxpayer may choose the rollover even if a replacement asset has not yet been acquired or expenditure to improve an asset incurred.
- There is no reduction in the cost base of the replacement asset when the capital gain is rolled over.

Example - Small Business Rollover

- Karen has a capital gain of $100,000. It has been reduced to $25,000 under the CGT discount and 50% active asset reduction.
- She purchases a new active asset for $20,000.
- $20,000 can be disregarded under the rollover leaving a final capital gain of $5,000, which will be assessable.
- The rollover relief does not, however, decrease the cost of the replacement asset for depreciation purposes.
- When the replacement asset is sold capital gains will be payable at that point, unless further rollover relief is utilised (i.e. keep purchasing active assets).

CGT Flowchart



CGT Small Business Contribution Cap

- CGT cap amount excludes certain amounts relating to small business concession from non-concessional contributions cap.

Income Year	CGT Cap
2019-20	$1,565,000
2018-19	$1,480,000
2017-18	$1,445,000
2016-17	$1,415,000

- Must be under 67 or satisfy the work test and make CGT cap election.

CGT Small Business Contribution Cap

- Amounts that will count towards a person's lifetime CGT cap when contributed to super are:
  - Capital proceeds from the sale of an active business asset that qualify for the 15-year exemption; or
  - Capital gains from the sale of an active asset that qualify for the $500,000 retirement exemption (not indexed).
- In addition to the above, to have a contribution count toward the CGT cap amount a client must complete a request on the approved form and give it to the super provider at or before the time the contribution is made.
- The ATO has published an approved form NAT 71161.
- It is not compulsory to use the ATO version of the form. These notifications can be made to the super fund in various ways and funds may create their own form for their members to use. The ATO form sets out the minimum data requirements.

Case Study

Case Study – Background Facts

- Flowers Pty Ltd runs a specialty flower consultancy, and was established in 2001 by the 3 Directors, Wayne, Barry and Sharon.
- Its annual turnover is $4.5 million. Flowers Pty Ltd has 900 ordinary shares on issue, held as follows:
  - Wayne Family Trust (WFT) – 300 ordinary shares
  - Barry Family Trust (BFT) – 300 ordinary shares
  - Sharon Family Trust (SFT) – 300 ordinary shares
- Each Director receives the majority of distributions from their Family Trusts.
- Let's also assume Wayne, Barry and Sharon were the Appointors of the respective Family Trusts.
- The Directors are approached by Interflora who offer to acquire the business for $15 million. Let's assume the cost base is nil.
- Wayne, 48, is our client and he asks us if the CGT Small Business Concessions apply, and whether (or not) he can get any money into his SMSF, and if so, how much?

Case Study – Background Facts

- Wayne’s wife Sharlene is aged 42, and between them they have a number of entities:
  - The Bri’onnii Equities Trust (BET) has a portfolio of listed equities valued at $2.25 million with a loan of $1 million (i.e. $1,250,000 net value). Sharlene owns 100% of the units.
  - Deeyahne Investment Pty Ltd has cash on deposit of $100,000, and 100% of the shares in this company are owned by WFT.
  - Wayne is the Appointor of WFT, and we already know this entity owns 1/3 of the shares in Flowers Pty Ltd.
  - Wayne and Sharlene jointly own an investment property valued at $1 million, which is debt free.
  - They also jointly own their family home, valued at $3.5 million and each have approximately $1.5 million in their SMSF ($3 million in total).
  - In his own right Wayne has a share portfolio through a margin lending facility ($250,000 portfolio with $150,000 debt).
  - Sharlene has a managed fund portfolio of $1 million.

Case Study – Implications for WFT

- The first step is to determine whether WFT satisfies the basic conditions for claiming the small business CGT concessions on the sale of its shares in Flowers Pty Ltd.
- Small Business Entity Test – did WFT carry on a business during the year, and is the aggregated turnover of WFT, including connected entities and affiliates, <$2m?
- NO – WFT did not carry on a business.
- Net Asset Value (NAV) Test – does WFT, together with its connected entities and affiliates, have NAV of $6 million or less?

Case Study – Implications for WFT

- Application of the Net Asset Value (NAV) Test:

Entities	Connected?	Reasons
Wayne	Yes	'Controls' the entity
Sharlene	No	Doesn't necessarily act in accordance with Wayne
BET	No	Sharlene holds 100% of units
Deeyahne	Yes	Shares owned 100% by WFT

- The other Family Trusts are not connected entities, as:
  - No receipt of capital or income distribution.
  - Not reasonably expected that trustee would apply capital or income for the benefit of Wayne, or his connected entities or affiliates.

Case Study – Total Net Asset Value

Super Concepts

- Total NAV of WFT and its connected entities:

Entity	Net Value
Wayne Family Trust (WFT)	$5,000,000
Half of jointly-held property	$500,000
Share portfolio	$100,000
Total	**$5,600,000**

- Result – ***satisfies the Net Asset Value Test***.
- Wayne is Appointor of WFT and the trustee would reasonably be expected to act in accordance with his wishes.
- He also receives the majority of distributions.
- Spouses are not automatically connected entities, although can be affiliates (act in accordance with wishes, passive asset used in business, etc).

Case Study – Other Requirements

Super Concepts

Active Asset Test

- The 80% 'look-through test' where there is a company or trust means 80% of the market value of the company's assets must be active assets.
- As Flowers Pty Ltd is a consulting business and consists of no assets other than Goodwill, this requirement is satisfied.

CGT Concession Stakeholder requirement

- As WFT is selling shares in Flowers Pty Ltd, CGT Concession Stakeholders of Flowers Pty Ltd must have together a Small Business Participation Percentage (SBPP) of 90%.
- Remember CGT Concession Stakeholder is someone who satisfies the Significant Individual test.
- Significant individual of a company or trust is someone who holds a direct or indirect interest of at least 20%.
- Where a discretionary trust owns 1/3 of the shares in a company, we need to determine WFT's SBPP in Flowers Pty Ltd.

Case Study – Other Requirements

- Therefore in order for Wayne to be a Significant Individual in Flowers Pty Ltd, he will need to receive 60% of the distributions in WFT:
  - 33.34% x 60% = 20%.
- As long as Wayne receives at least 60% of the distributions made by WFT *in the financial year*, he will be a Significant Individual of Flowers Pty Ltd.
- This in turn means that Wayne is a CGT Concession Stakeholder in Flowers Pty Ltd at the time of the shares sale.
- ***As long as CGT Concession Stakeholders receive between them at least 90% of WFT's current year distributions, the 90% requirement will be satisfied.***
- Remember the Spouse of a Significant Individual can also be a CGT Concession Stakeholder if they have a SBPP of >0%.
- ***Sharlene also entitled to the Small Business CGT Concessions.***
- Therefore worthwhile WFT making a distribution to Sharlene.

Case Study – Small Business 50% Reduction

- The tax implications for the beneficiaries of WFT are:
  - Apply the 50% CGT discount to the gross capital gain of $5 million.
  - Apply the 50% active asset reduction to the discount capital gain of $2.5 million.
  - If no other concessions are utilised, the taxable capital gain would be $1.25 million – i.e. 25% of the gross capital gain.
  - Assuming the top marginal tax rate of 45%*, the tax payable by beneficiaries would be $1,250,000 x 45% = $562,500, leaving net proceeds of $4,437,500.
  - This is an effective tax rate of 11.25% ($562,500/$5,000,000).
  - * Ignores the Medicare Levy.

Case Study – Small Business 50% Reduction

Tax Payable	**WFT**
Capital proceeds on sale	$5,000,000
Less 50% discount	($2,500,000)
Net capital gain	$2,500,000
Less 50% active asset reduction	($1,250,000)
Taxable Income	$1,250,000
Tax payable (assume 45%)*	($562,500)
Net proceeds received	**$4,437,500**

- * Ignores the Medicare Levy.

Case Study – Retirement Exemption

- The tax payable may be further reduced to around 2% by using the Retirement Exemption:
  - As Wayne is a Significant Individual of Flowers Pty Ltd, and Sharlene his Spouse, payments can be made for each of them under the Retirement Exemption.
  - The choice to apply the Retirement Exemption will be made at the time of lodging WFT's tax return.
  - As both Wayne and Sharlene are less than 55, the payments must be made to a complying super fund.
  - Assuming neither has previously used the exemption, they each have the full $500,000 lifetime limit available.
  - The net taxable gain will be reduced by $1 million to $250,000.
  - The net proceeds received are now $4,887,500 - a savings of $450,000 ***(although $1 million is preserved in super).***

Case Study – Retirement Exemption

Tax Payable	WFT
Capital proceeds on sale	$5,000,000
Less 50% discount	($2,500,000)
Net capital gain	$2,500,000
Less 50% active asset reduction	($1,250,000)
Taxable capital gain	$1,250,000
Less Retirement Exemption	($1,000,000)
Taxable Income	$250,000
Tax payable (assume 45%)*	($112,500)
Net proceeds received	**$4,887,500**

- This is an effective tax rate of 2.25% ($112,500/$5,000,000).
- * Ignores the Medicare Levy.

Case Study – Asset Rollover

- This concession can be used in addition to the Retirement Exemption where the remaining gain exceeds the lifetime limit.
- WFT could use the replacement asset rollover to reduce the tax payable on the share sale to nil.
- WFT would invest $250,000 in a replacement active asset, or improvements to an existing asset, within a period starting one year before the CGT event and ending two years after the CGT event.
- Shares in a company or an interest in a trust can qualify, subject to certain conditions:
  - Must be Australian resident trust or company.
  - Active assets must be at least 80%.
  - CGT Concession Stakeholder and Significant Individual.
  - Modified connected entity rule.
  - Modified active asset test
  - 90% Test (SBPP).

Summary

- Simple concept, but very complex rules.
- *Determining the eligibility requirements is where most mistakes are made.*
- You need to work through the requirements and facts of the client case to determine the best outcome.
- Also forward planning regarding structure can maximise concessions.
- The concessions can be very generous and knowledge of the rules helps build our Client Value Proposition.

Thank you.