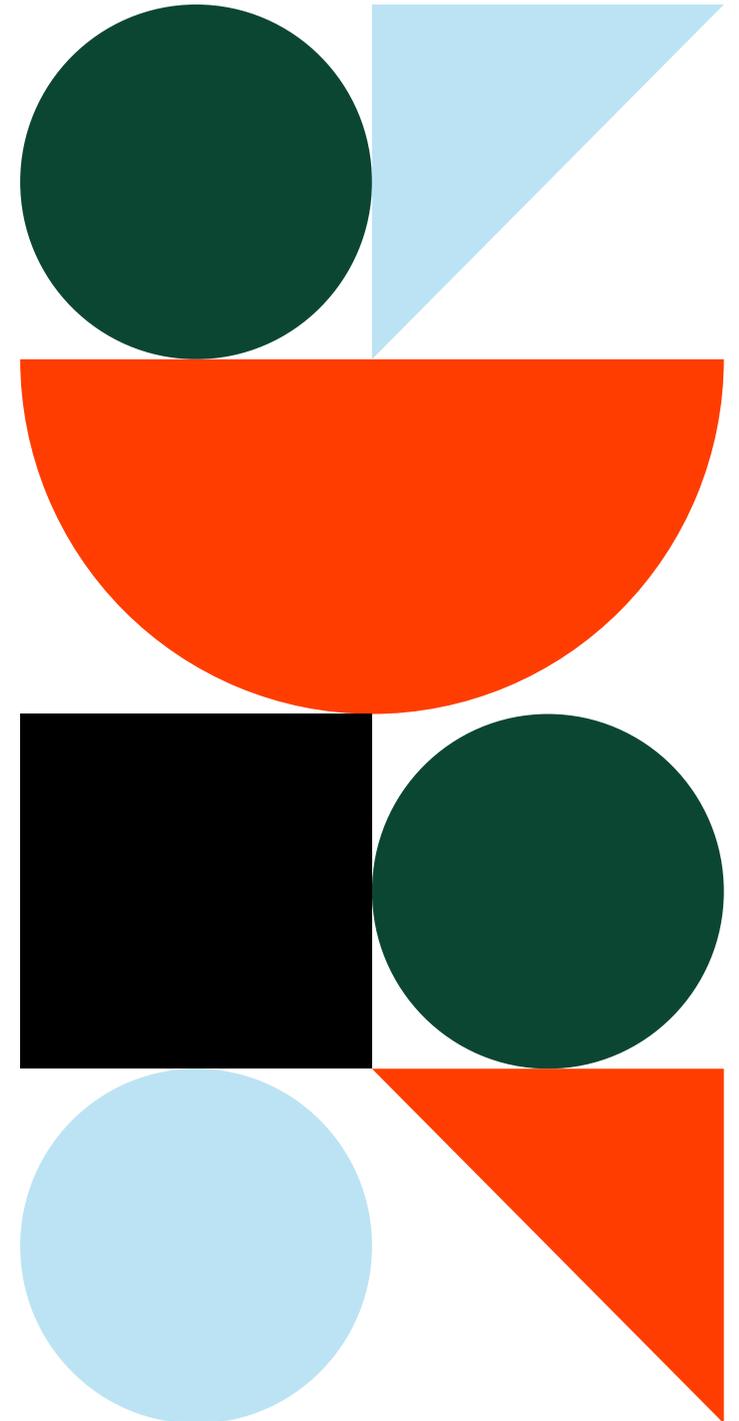

Small Business CGT Concessions

Step by step framework on how to implement the concessions for a business exit, sale of business property or the sale of shares and units.

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Step One Identification Stage

- A Identify the assets being sold. Common examples include real property, intellectual property, a partnership interest, goodwill, shares and units. Some assets are ineligible for the Concessions (e.g. depreciating assets and trading stock). Others have additional requirements (e.g. shares and units).
- B Identify the taxpayer. Individual, Trust or Company? Trust and Companies have additional requirements. The additional requirements are more complex if the owners of the trust/company are not individuals.
- C Identify the capital gain.
- D Identify the CGT event.
- E Identify when the CGT event occurs.
- F Identify how long the CGT asset held been held for.
- G Who is 'connected with the taxpayer' (different rules for companies, unit trusts and discretionary trusts).
- H Who is an 'affiliate' of the taxpayer (sometimes a spouse is an affiliate)

Step Two Satisfy Basic Conditions

Test 1 - Active Asset Test

Asset must be 'active asset' for at least half ownership period (or 7.5 years). Where property, consider:

- A What period of time the property has been used in a business?
- B How much (%) of the property has been used in a business?
- C If the taxpayer has not conducted a business – which entity has? Are they a 'connected entity' or an 'affiliate'?

VL Pro Tip

Some CGT assets can satisfy the active asset test even if they are not currently active! (e.g. a property previously used in a business)

Test 2A - Small Business CGT Entity

Must be a CGT small business entity for the income year.

Must be 'carrying on a business' (note – generally easier for companies to satisfy this requirement).

Aggregated turnover for current income year (or previous income year) must be less than \$2 million. Turnover is ordinary income derived in the ordinary course of carrying on a business. Ensure that turnover of affiliates and connected entities is included.

VL Pro Tip

This test is usually relied on when the MNAV failed. The concessions can apply where an asset is sold for **more than \$6 million** if this test is used (instead of the MNAV).

VL Pro Tip

This test can also be used if the CGT asset is used by a connected entity or affiliate that is a CGT small business entity.

Test 2B - MNAV Test

'Net assets' must not exceed \$6 million 'just before' CGT event. Items that increase the MNAV:

- A 'Market value' of assets
- B 100% of the value of assets held by connected entities or affiliates
- C Non-business assets (unless excluded)
- D Earn out rights.

Items that reduce the MNAV / not included:

- A Liabilities (if related to CGT assets)
- B Main residence (but only if not used to derive assessable income)
- C Personal assets (but only if solely used for personal use/enjoyment)
- D Superannuation
- E Assets owned by an entity connected with you only because of your affiliate.

VL Pro Tip

Ensure that provisional MNAV calculations are performed **before** a CGT event occurs. There may be planning opportunities available!

Step Three Satisfy additional 'Basic' Conditions (share/units sold)

1 - 80% Test

To determine whether shares/units active, apply the 80% Test. The following must be more than 80% of the market value of all of the assets of the company or trust:

- A Active assets (based on their market value);
- B Financial instruments that are 'inherently connected'; and
- C Cash of the company or trust that is inherently connected.

VL Pro Tip

Issues may arise where a company has significant cash or loan receivables. In that case, a period by period analysis may be required, and periodic asset valuations for relevant assets (e.g. goodwill).

2 - Modified 80% Test

In addition to the above, a second test must be performed. Broadly, the assumptions:

- A Remove cash and financial instruments, if those assets acquired that asset for a purpose that included assisting an entity qualify for the original 80% Test; and
- B Remove any shares / units that the taxpayer itself holds from the test, and look through to the underlying assets instead (but only if the taxpayer holds a sufficient interest [20%] in the company/trust).

VL Pro Tip

The modified 80% Test is complex. It must be carefully considered where the company/trust in question has significant cash or financial instruments, or where the company/trust holds interests in other entities.

3 - Object Entity Test

A test must be performed on the object entity itself (e.g. the company which the taxpayer holds shares in). The object entity must either:

- A Satisfy a modified MNAV Test itself (based on the company's assets, affiliates, and entities that the company holds at least 20% in); or
- B Be a CGT small business entity (based on the company's turnover – including entities owned by the company)

VL Pro Tip

Unlike the normal connected entity rules, these rules apply 'downwards' only (i.e. the shareholders themselves are not connected under these modified tests)

4 - Carry on Business (Integrity Rule)

If the taxpayer is relying on being a CGT small business entity (rather than satisfying the MNAV test), they must be carrying on a business just before the CGT event.

This is to close a "loophole" where the taxpayer could previously commence carrying on a business after the CGT event!

VL Pro Tip

This requirement does not apply where CGT assets other than shares are disposed of (for example, property).

5 - Sufficient Ownership

The taxpayer must have a sufficient ownership stakeholder in the company/trust.

- A If the taxpayer is an individual – they must be a 'CGT concession stakeholder' (requiring a small business participation percentage of at least 20% or spouse of the former that has an SBPP greater than 0%).
- B If the taxpayer is not an individual (e.g. discretionary trust) – CGT concession stakeholders in the company/trust together have a SBPP in the taxpayer of at least 90%.

VL Pro Tip

This requirement becomes important where a discretionary family trust sells shares in a company or units in a unit trust. In those situations, the discretionary family trust must ensure that it distributes its income/capital in a particular way.

Step Four Review and Confirm on Basic Conditions

Review and double check basic conditions!

If in doubt regarding whether the basic conditions are met – seek professional advice before claiming any concessions.



Step Five Apply 15-Year Exemption, if available

The 15-year exemption applies in preference to the other concessions. The CGT asset must have been continuously owned for 15 years. Further requirements depend on whether the taxpayer is an individual or an entity (company or trust).

Individuals

- A Must be either:
 - i) 55 or over at the time of the CGT event and the event happens in connection with your retirement;
 - ii) Permanently incapacitated at the time of the CGT event.
- B If shares/units sold – the company/trust must have had a 'significant individual' for a total of at least 15 years (note – the significant individual can vary year to year)

Companies/Trusts

- A the taxpayer must have had a significant individual for a total of at least 15 years during which the entity owned the CGT asset (note – the significant individual can vary year to year);
- B there must be a 'significant individual' of the taxpayer who:
 - i) was 55 or over at that time and the CGT event happened in connection with the individual's retirement; or
 - ii) was permanently incapacitated at the time of the CGT event.

VL Pro Tip

Where the taxpayer is a trust, consider if there are any individuals who could meet the retirement or permanently incapacitated criteria.

VL Pro Tip

The terms 'in connection with retirement' and 'permanently incapacitated' are not defined. Seek advice if in doubt.

VL Pro Tip

The 15-year exemption allows a company or trust to pay the disregarded capital gain to shareholders / beneficiaries as **non-assessable non-exempt income** (i.e. tax-free). This also applies to assets that are pre-CGT!

Step Six Apply other Concessions, if available

If the 15-year exemption cannot apply, consider which other concessions to apply. Remember – these concessions can be applied in any order!

50% Active Asset Reduction

This concession reduces the capital gain by 50%.

VL Pro Tip

This concession is straightforward however there may be instances where a taxpayer chooses not to apply the reduction. A common example is where a company makes a capital gain, as it can be easier to extract the disregarded capital gain using the retirement exemption.

Retirement Exemption

A capital gain of up to \$500,000 (per individual) can be disregarded using this concession. Individuals have a **lifetime** limit of \$500,000 under this concession.

VL Pro Tip

Depending on the situation, it is possible to disregard up to \$4 million using this concession! (as it is possible to have eight CGT concession stakeholders).

Individuals

If under 55 the choice is made to apply the retirement exemption, an equivalent amount must be contributed to superannuation. Otherwise, optional ability to contribute (subject to age limits on contributions).

Companies / Trusts

- A Taxpayer must have a 'significant individual';
- B Must choose how it wishes to apply the retirement exemption (individuals must be 'CGT concession stakeholders'), and document it in writing;
- C Must make payments within seven days of making the choice:
 - i) If individual is under 55 just before payment is made, taxpayer must pay funds to superannuation on the individuals behalf;
 - ii) Otherwise – taxpayer must make a 'payment' to the individual.

Small Business Roll-Over Exemption

Any amount of capital gain can be disregarded using the small business roll-over exemption. No other conditions. Amount disregarded until either ...

- A **Two years after the CGT event**

If taxpayer does not acquire a 'replacement asset' or 'fourth element cost base expenditure' within the 'replacement asset period' (generally a three year period - starting one year before CGT event and ending two years after the CGT event)
- B **Indefinitely**

Until, the replacing asset is either disposed of or ceases to be a qualifying asset (e.g. no longer an active asset, or under 20% interest in an entity).

VL Pro Tip

If/when CGT event J5 or CGT event J6 occur, any concessions not originally chosen can be applied (e.g. retirement exemption). If CGT event J2 applies, the same can apply, however a full re-testing must occur (e.g. MNAV test or CGT small business entity).