Pocket

Summary

Estate Planning
Superannuation,
Trusts, Tax &
Asset Protection

Small Business CGT Concessions

moores

Small business owners have the prospect of **no (or greatly reduced) CGT** (if able to be structured appropriately)

To qualify, they must:

- Satisfy all applicable **preconditions** in Subdivision 152-A
- Fit within one or more of the **exemptions or concessions** in Subdivisions 152-B, 152-C, 152-D or 152-E

Importance of the Small Business CGT Concessions

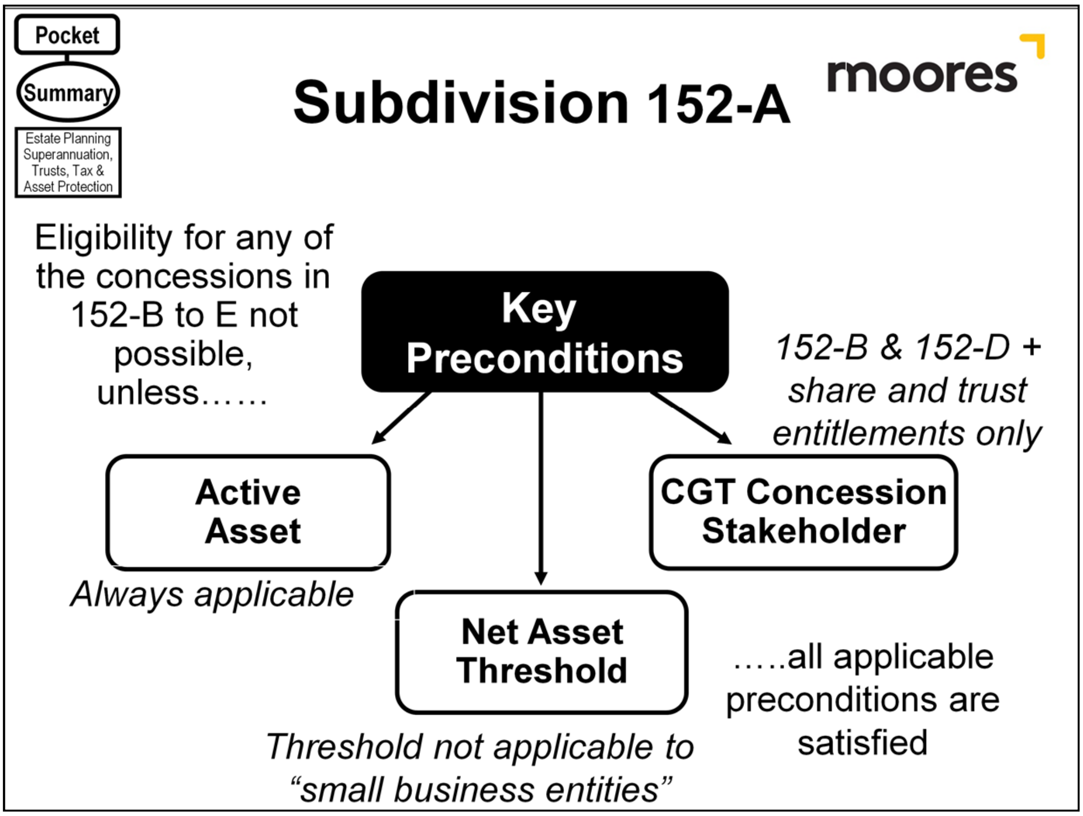
There are 2 major exemptions from capital gains tax ("CGT") in Australia, set out in the *Income Tax Assessment Act 1997* ("*ITAA 1997*") . One, the exemption for main residences or family homes (Division 118), is one that most people seeking the exemption have little difficulty obtaining. The other, the exemption for the "active" assets of small businesses in Division 152 has hurdles that can be difficult to overcome (particularly without forward planning), but can mean that many principals of owner controlled businesses have the prospect of a CGT exemption (or a considerable reduction in CGT) when they sell or transfer their business equity.

Active Assets

Active assets are defined in sections 152-35 to 152-45. They must be used in the business and can be owned by the entity (or individual) that is conducting the business or by an affiliate (as defined by Division 328 – the definition excludes superannuation fund ownership). Potential active assets include:

- Business goodwill;
- Business premises; and
- Trade marks, franchises and licences.

Business assets taxed on revenue (rather than capital) account, eg trading stock and depreciable intellectual property such as copyright, are not considered "active". Also excluded are assets that are not integral to the business principal's business, eg farming land agisted to third parties. A property run as a bed and breakfast has the potential to be an active asset, whereas the same property leased on a longer term basis to third party tenants would not be an active asset.



(Up to) 3 Initial Hurdles – Subdivision 152-A

The hurdles that need to be overcome are:

• The requirement that the **assets** be "**active**" and used in, or forming an integral part of, a business.

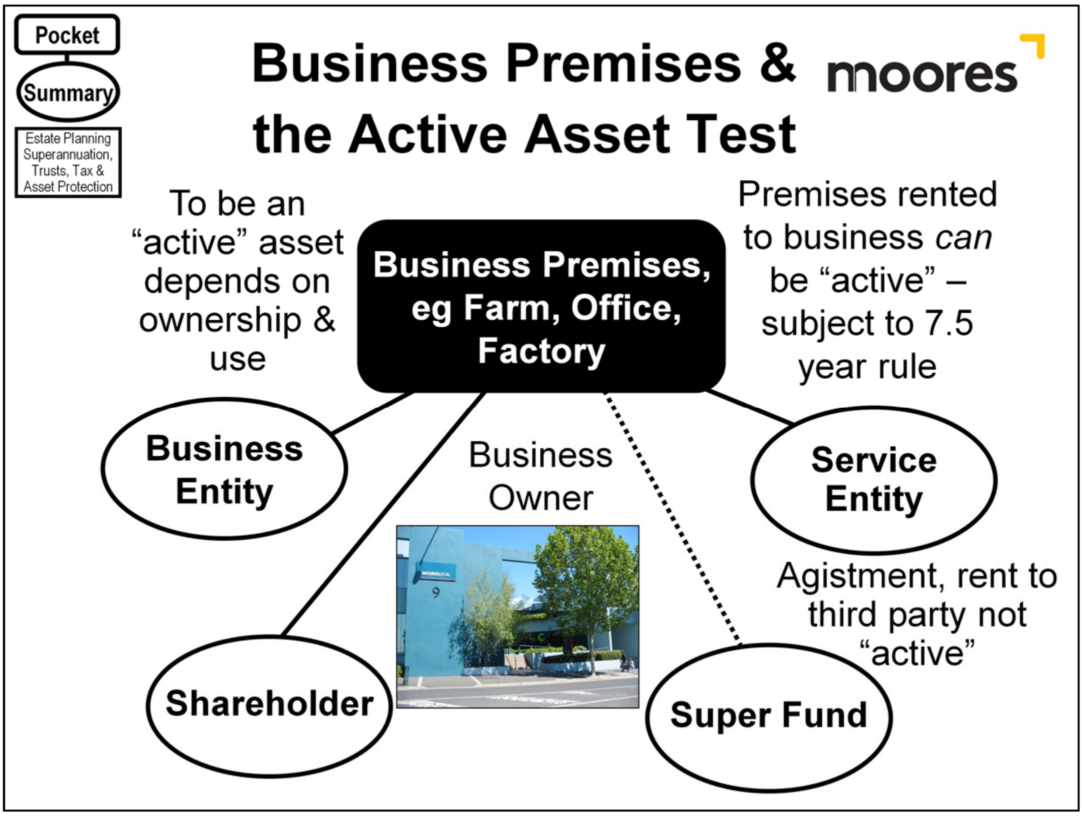
• Minimum 20% direct **control** (or 20% or 90% indirect control) requirements by an individual apply in most cases for interests in companies and trusts (sections 152-50 to 152-60 of *ITAA 1997*); the rules for determining control depend on the type of entity involved and the concessions also apply to spouses of individuals who meet the 20% control requirements. There are separate control requirements for companies, fixed trusts and non-fixed trusts. The control requirements also apply to the sale of a business owned by a company or trust for 2 of the 4 concessions that can apply, namely the small business exemptions in Subdivisions 152-B and 152-D.

• Unless the business is a **small business entity** under Division 328 (and thus has an aggregated annual turnover of less than $2 million, a **$6 million asset limit** applying to the "CGT" assets of "CGT concession stakeholders". This $6 million limit can apply to business assets in related entities such as companies and trusts, but does not apply to excluded assets such as:

  • personally owned assets used for private use and enjoyment, eg family homes and non-income generating holiday homes; and

  • superannuation.

Both the $6 million limit (if applicable) and the 20% or 90% control requirements mean that care needs to be taken with distribution of family/non-fixed trust income and capital.



7.5 Year Rule

Business premises potentially qualify for the Division 152 concessions if they were active for at least either 7.5 years or half the period of ownership (whichever is the lesser).

Limitations of ID 2002/405

ATO *Interpretative Decision* ID 2002/405 deals with the issue of individuals (who are also the shareholders in the trading company operating out of the business premises) owning business premises. In this example the two individuals are clearly significant individuals for the purposes of Division 152. Other structures, eg involving an SMSF owning the premises need to be carefully considered.

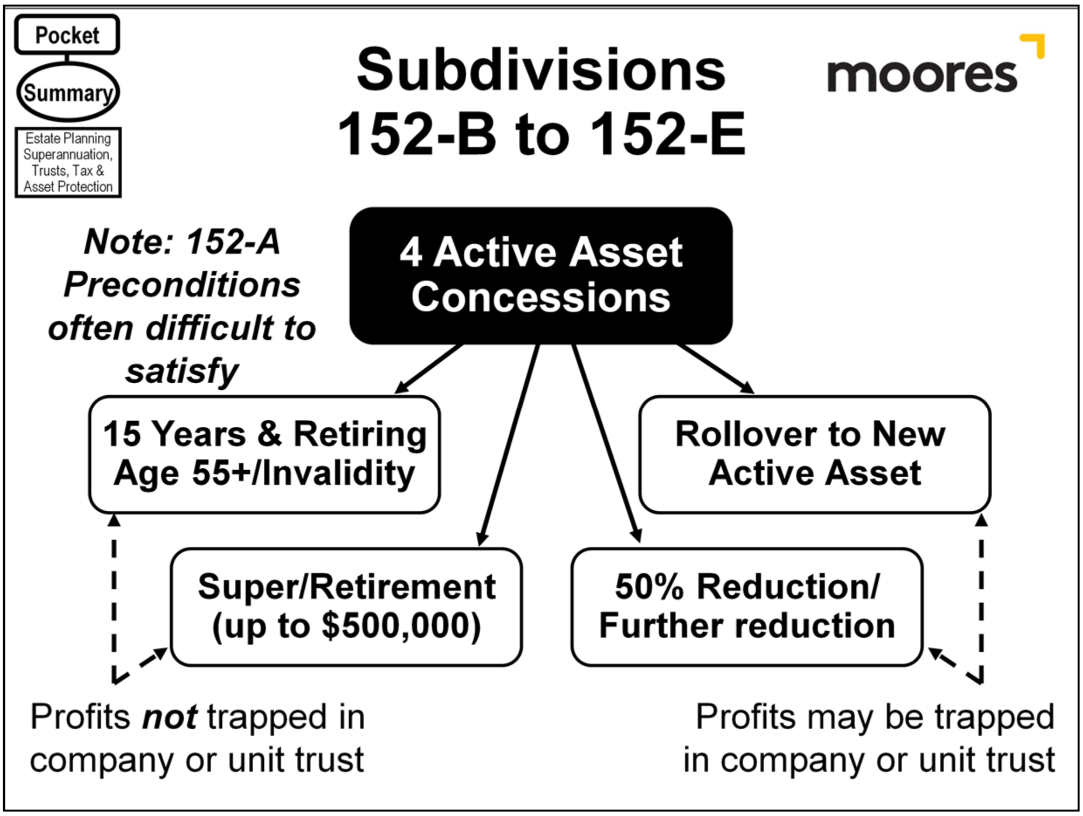
Specific Issue Addressed in ID 2002/405

"Are premises owned by two individuals, but leased to and used by a company in the course of carrying on a business, an active asset under section 152-40 of *ITAA 1997*, where the company is an entity connected to the individuals?" In ATO *Interpretative Decision* ID 2002/405 the two individuals each own 50% of the share capital of a company which operates a business. They also own, in joint names, the business premises from which the company operates its business.

The individuals treat the premises as a commercial rental property and charge the company market rent value for its use. The premises is to be sold and the owners will acquire other premises from which the company will carry on its business.

Paragraph 152-40(e) Distinguished

In ATO *Interpretative Decision* ID 2002/405, the ATO makes the important distinction between the main use of premises being to derive rent and the main use being to derive business income – the connection between the owners, the business entity and the use of the property is the critical issue. Where entities such as SMSFs are involved, it is arguable that the connection still exists, but is less clear cut.



Qualifying for the 4 Concessions

Once past the various tests associated with these preconditions, the 2nd major issue for the small business principals to address is satisfying the particular tests for the exemption, discount or rollover relief under the Subdivisions 152-B to 152-E.

Note: The summary below is very general and there are drawbacks for all 4 tests. Each test has particular drawbacks requirements or drawbacks that need to be met.

Subdivision 152-B – a complete exemption for retirees holding an active asset and who satisfy both the 15 year holding requirement and the retirement or invalidity requirement – to the extent that this concession applies and is taken up, the other concessions are irrelevant.

Subdivision 152-C – a 50% discount or further discount on the capital gains tax that would otherwise be payable – this concession is often used in conjunction with Subdivision 152-D.

Subdivision 152-D – a tax free payment (CGT ETP) with a cumulative lifetime limit for all CGT ETPs of $500,000. The money qualifying under this concession must be paid into superannuation if the CGT concession stakeholder is under 55 years at time of the payment is due to be paid and is part of the $1 million lifetime superannuation contributions limit for small business sale proceeds.

Subdivision 152-E – providing full or part rollover relief for an asset that is wholly or partly replaced within the period a year prior to and 2 years after the CGT event.

"Significant Individual" and Small Business Participation Percentage"

These prerequisites, requiring at least 20% direct or 20% or 90% indirect equity, in Subdivision 152-A apply to any sale of shares, units or trust entitlements, as well as in the Subdivision 152-B and 152-D concessions.