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Small business capital gains tax concessions

DARIUS HII, CTA
DIRECTOR, CHAT LEGAL PTY LTD

Overview

- ◆ Overview of the small business CGT concessions
- ◆ Recent changes to the rules and when they will be relevant
- ◆ Case study examples

Small business CGT concessions

- ◆ Tax concessions for small businesses selling business assets
- ◆ 15-year exemption - capital gain from disposing an active asset can be disregarded if held continuously for 15 years and the taxpayer is aged over 55 and is retiring or permanently incapacitated
- ◆ 50% active asset reduction – capital gain from disposing an active asset is reduced by 50 per cent (in addition to the general capital gains discount available for assets that are held for 12 months or more)
- ◆ Retirement exemption - capital gains from disposing active assets are exempt up to a lifetime limit of \$500,000 if the proceeds are used in connection with retirement
- ◆ Rollover relief - deferring all or part of a capital gain made from disposing an active asset.

General conditions - old law

- ◆ A CGT event occurs
- ◆ A capital gain arises
- ◆ Either the:
 - ◆ \$2m turnover test is satisfied
 - ◆ \$6m maximum net asset value test is satisfied
 - ◆ Variations to the above two rules are satisfied
- ◆ Asset satisfies the active asset test
- ◆ **If asset is a share in a company or an interest in a trust, then either (share condition):**
 - ◆ Taxpayer is a CGT concession stakeholder
 - ◆ CGT concession stakeholders hold at least a 90% small business participation percentage

Turnover and 'MNAV' test

- ◆ Turnover test requires the taxpayer to be an entity conducting a business with an aggregated turnover of less than \$2 million
 - ◆ Aggregated turnover includes the turnover of entities connected with the taxpayers and affiliates of the taxpayer
- ◆ MNAV test requires the taxpayer and entities connected with the taxpayer; and affiliates with the taxpayer (or entities connected with the taxpayer's affiliates) hold CGT assets less than \$6 million
- ◆ Prior to any proposed changes, the 'connected with' threshold was 40%
- ◆ Connected with includes entities that are *controlled* by a same third entity

Proposed changes

◆ 2017-2018 Federal Budget

The Government will amend the small business capital gains tax (CGT) concessions to ensure that the concessions can only be accessed in relation to assets used in a small business or ownership interests in a small business. This measure will take effect from 1 July 2017. This measure is estimated to have an unquantifiable gain to revenue over the forward estimates period.

*The concessions assist owners of small businesses by providing relief from CGT on assets related to their business which helps them to re-invest and grow, as well as contribute to their retirement savings through the sale of the business. However, **some taxpayers are able to access these concessions for assets which are unrelated to their small business, for instance through arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.***

Proposed changes

Additional basic conditions for shares in a company or interests in a trust

- (2) The following additional basic conditions must be satisfied if the *CGT asset is a *share in a company, or an interest in a trust, (the **object entity**):
- (a) the CGT asset would still satisfy the active asset test (see section 152-35) if the assumptions in subsection (2A) were made;
 - (b) if you do not satisfy the maximum net asset value test (see section 152-15)—you are carrying on a *business just before the *CGT event;
 - (c) either:
 - (i) the object entity would be a *CGT small business entity for the income year; or
 - (ii) the object entity would satisfy the maximum net asset value test (see section 152-15);if the following assumptions were made:
 - (iii) the only CGT assets or *annual turnovers considered were those of the object entity, each affiliate of the object entity, and each entity controlled by the object entity in a way described in section 328-125;
 - (iv) each reference in section 328-125 to 40% were a reference to 20%;
 - (v) no determination under subsection 328-125(6) were in force;
 - (d) just before the CGT event, either:
 - (i) you are a *CGT concession stakeholder in the object entity; or
 - (ii) CGT concession stakeholders in the object entity together have a *small business participation percentage in you of at least 90%.



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Change to Share Condition #1

- ◆ “The CGT asset would still satisfy the active asset test (see section 152-35) if the assumptions in subsection (2A) were made” – Modified Active Asset Test
- ◆ Subsection (2A) states:
 - ◆ Cash and financial instruments are not active assets if they have been acquired for the purpose of assisting an entity to satisfy the active asset test
 - ◆ Shares in companies or units in a unit trust (**later entities**) held directly or indirectly by the object entity are not to be taken into account when determining the value of the object entity’s active asset
 - ◆ Active assets of the object entity includes assets held by other entities covered under section 152-10(2B) (entities in which the taxpayer has at least a 20% interest)
 - ◆ All assets of later entities are assets of the relevant entity looking to satisfy the active asset test
 - ◆ Assets of later entities are proportionate to the relevant entity’s interest in that entity

Reason for change

*This condition prevents the concession from being available for interests in entities if most of the value of the assets of the entity is unrelated to its business activities. In such cases, while the entity carries on a small business, **most of the value of the interest held by the taxpayer is not attributable to the small business and it is not appropriate for the small business concessions to apply to the disposal of the interest.** The condition also recognises that an investment is effectively passive in nature if an entity has an interest of less than 20 per cent in another entity*

Change to Share Condition #2

- ◆ “If the taxpayer does not satisfy the maximum net asset value test (see section 152-15) – you are carrying on a business just before the CGT event”

Example 1

Roger



Company A

Business sold for \$1 million capital gain
50% Active asset reduction (\$500,000)
\$500,000 → Retirement exemption – Pull
the related amount directly out of the
company, go to super (if individual under
55), or go to individual directly (if over 55)

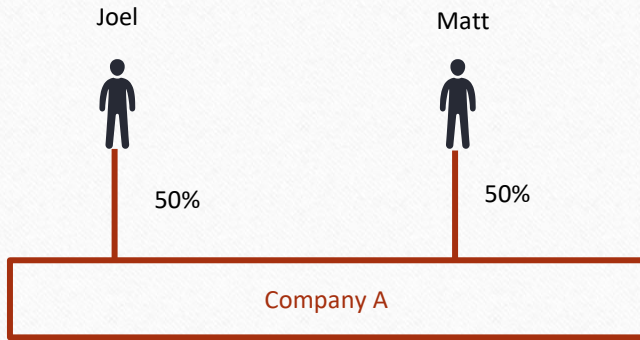
Reason for change

'[t]his ensures that entities do not benefit from this concession where the relevant business activities are too remote to justify the entity receiving a concession for business activities.'

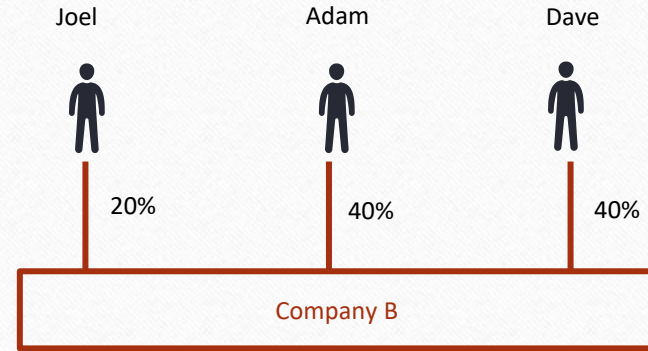
Change to Share Condition #3

- ◆ “either:
 - ◆ The object entity would be a CGT small business entity for the income year; or
 - ◆ The object entity would satisfy the maximum net asset value test;
- If the following assumptions were made:
 - ◆ The only CGT assets or annual turnovers considered were those of the object entity, each affiliate of the object entity, and each entity controller by the object entity in a way described in section 328-125;
 - ◆ Each reference in section 328-125 to 40% were a reference to 20%;
 - ◆ No determination under subsection 328-125(6) were in force”

Example 1

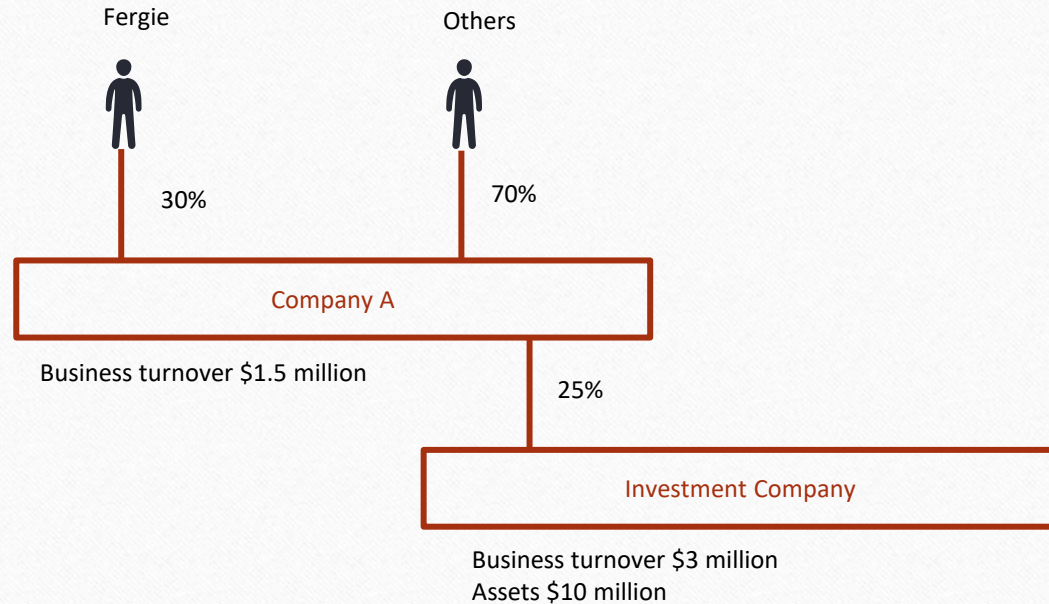


Business turnover \$1.5 million

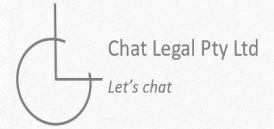


Business turnover \$2 million

Example 2



Client situations change to law affects



- ◆ Accessing the SBCGT concessions on the sale of shares in a company or units in a unit trust
- ◆ Where MNAV test not available for company selling business
- ◆ Where company or unit trust has multiple business owners
- ◆ Where company or unit trust has multiple business interests
- ◆ Where taxpayer has multiple business interests

FCT v Eichmann [2019] FCA 2155

- ◆ Taxpayer carried on business of building through family trust
- ◆ Block of land was owned which held 2 x sheds used to store work tools, equipment and materials; as well as park work vehicles and trailers
- ◆ Block of land was sold and the question was whether the property was an active asset
- ◆ Initially held in *Eichmann and FCT* [2019] AATA 162 that property was “*used, or ready to for use, in the course of carrying on a business*”
- ◆ ATO appealed

FCT v Eichmann [2019] FCA 2155 cont.



- ◆ Court held for an asset to qualify as an active asset – needs to be established that the whole, or predominantly the whole, of the asset had been used in the course of carrying on a business
- ◆ Specifically **the asset be used “in the carrying on of the business”** rather than merely “in the business” indicated that the use must be in relation to activities directed to the gaining or production of assessable income
- ◆ In other words, there needs to be a direct functional relevance to the carrying on of the normal day-to-day activities
- ◆ The storage of tools and work equipment does not have enough of a connection in relation to the ordinary day-to-day activities of the business
- ◆ At best, the land was used “in relation to” the carrying on the business

Miley and FCT [2019] AATA 5540



- ◆ The taxpayer and 2 others owned a 1/3 interest in a company
- ◆ The company was sold for \$17.7m, each shareholder receiving \$5.9m
- ◆ Dispute arose in relation to the ability to access the \$6 million MNAV test
- ◆ Prior arguments related to the fact that the market value of the 1/3 interest in the company was less than \$5.9m due to the fact that a 1/3 interest did not grant the buyer control in the company – thereby, there should a ‘minority shareholder’ discount (which was dismissed after succeeding in first instance)
- ◆ Current argument was that the \$5.9m related to the taxpayer’s shares in the company **and** non-compete rights (of which those rights only arose **after** the CGT event, being the signing of the sale contract)

Miley and FCT [2019] AATA 5540 cont.



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- ◆ Expert evidence agreed that absent of the non-compete clauses, the buyer would have bought the shares for less than the sold value
- ◆ Non-compete clause valued at \$1.6 million
- ◆ AAT took approach to view the transaction holistically, specifically, that the terms of the non-compete being included was a factor prompting the buyer to buy (as the acquired goodwill would be protected from competition from the sellers)

Contact details



Darius Hii, CTA

Director, Chat Legal Pty Ltd

Phone: 0403923374

Email: darius@chatlegal.com.au

Address: Level 6, 200 Adelaide Street, Brisbane, QLD 4000

Twitter: @darius_hii