

# TAX RETREAT NEW CALEDONIA

24 – 25 MAY 2017

Chateau Royal, Noumea

SBE CGT & Ancillary  
Concessions

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Session 6



IPA INSTITUTE OF PUBLIC  
ACCOUNTANTS

## SBE CGT Concessions

- **Small business CGT Concessions:**

- CGT 15-year asset exemption
- CGT 50% active asset reduction
- CGT retirement exemption
- CGT roll-over

## Small business CGT concessions: methodology

Start with basic conditions

Then consider the 4 concessions

(3 of the 4 concessions have further conditions)

## SBE CGT Concessions

- Basic conditions for eligibility to small business concessions:
- - CGT event happens to an asset that the taxpayer owns
  - event would otherwise have resulted in a capital gain
  - taxpayer must either:
    - (1) be a "small business entity"; or
    - (2) satisfy the maximum net asset value test (\$6M), and
  - asset satisfies the active asset test
  - If asset is a share in a company or interest in a trust, the company / trust must have CGT concession stakeholder.

## Basic conditions: Step 1

A CGT event must have occurred in relation to a CGT asset

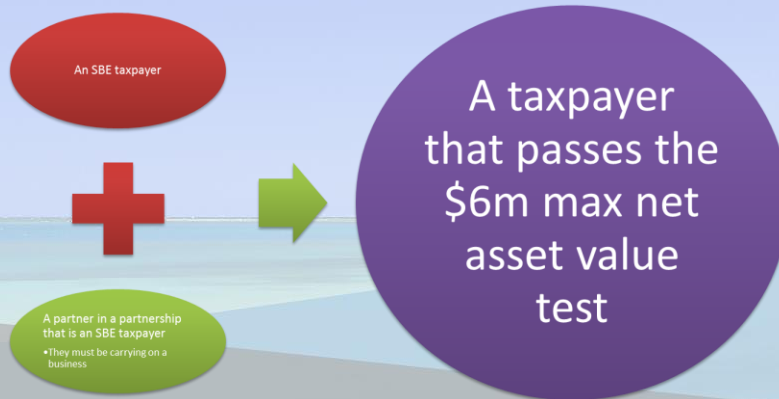
Not relevant to:

- A gain/loss on a pre-CGT asset
- CGT event K7 occurs
- There has been a capital loss

## Step 2: CGT event

A capital gain must arise as a result of the CGT event

Basic conditions Steps 3(a) & (b): who can access the concessions?

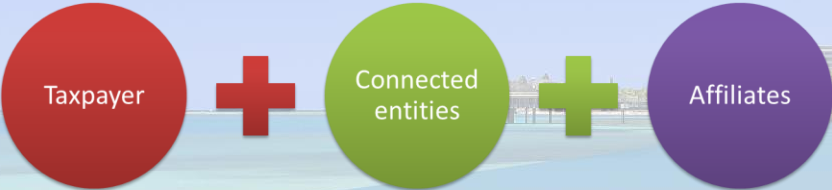


## SBE CGT Concessions – SBE requirement<sup>1</sup>

### Small Business Entity (SBE) Requirement:

- SBE must carry on a business and satisfy a \$2m "aggregated turnover" test
- Can be based on aggregated turnover for the previous year or the current year
- Aggregated turnover is sum of SBE annual turnover and the annual turnovers of connected or affiliated entities

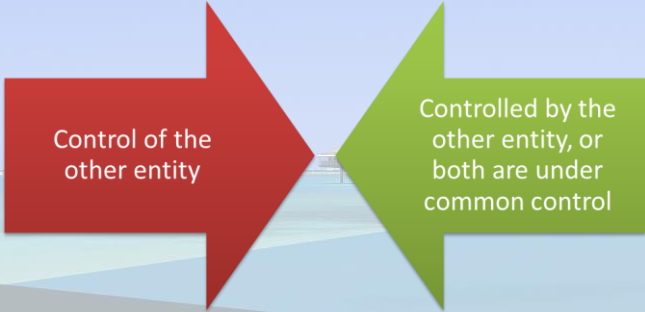
# Maximum NAV Test: NAV less than \$6m



# SBE CGT Concessions - NAV Calculation

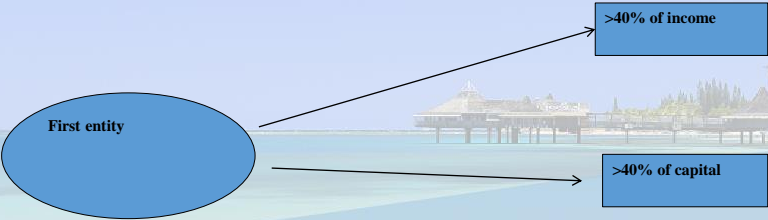


# Connected with



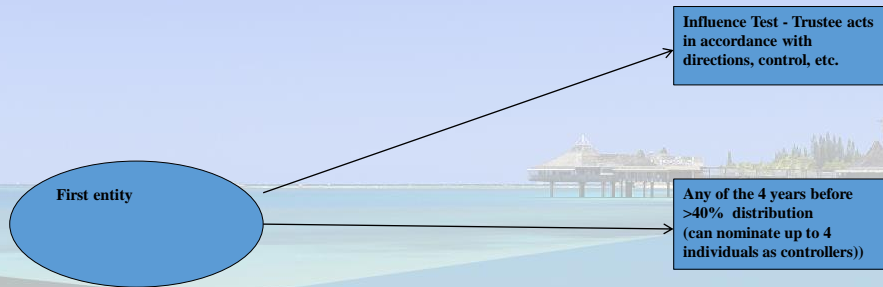
# CGT Small Business Concessions (continued)

## Connected entity - Control (other than discretionary trust)



## CGT Small Business Concessions (continued)

- Control of a discretionary trust



## Discretionary Trust: control

Distribution  
test

Influence  
test

# Affiliate

If they act, or could reasonably be expected to act in accordance with the taxpayer's directions or wishes; or

In concert with the taxpayer

# Basic conditions step 4: CGT asset an active asset?

The taxpayer has owned it for < 15 years

And the asset was an active asset for a total of at least half of the test period OR

The taxpayer has owned it > 15 years

And the asset was an active asset for a total of at least 7.5 years during the test period

Test period begins when the asset was acquired & ends at:

The CGT event or

When the business ceased,

Whichever occurs earlier



## Basic conditions step 4: what is an active asset?

Assets used in a business of the taxpayer, an affiliate entity or connected entity of the taxpayer

Includes an intangible asset e.g. goodwill – inherently connected with the business

A share in a resident company or interest in a resident trust, where market value of the entity's active assets, connected financial instruments & cash is greater than 80% of the total market value of the entity

## SBE CGT Concessions – SBE requirement<sup>1</sup>

- **Active asset requirement**
- Used in the course of carrying on a business by taxpayer, connected entity or affiliate
- The following are not active assets
  - Assets whose main use is to derive rent, royalties or FX gains – recent case re holiday park
  - Shares in widely held companies or trusts
  - Financial instruments

# SBE CGT Concessions – SBE requirement<sup>1</sup>

- **Active asset requirement**

- The 80% rule is a “look through” test to ensure interests in companies and trusts meet the active asset test
- Market values of active assets and financial instruments (cash) inherently connected with the business - **must exceed 80% or more of the market value of all assets of the trust**

Basic conditions step 5: CGT asset is a share in a company or interest in a trust

CGT concession stakeholder

Small business participation percentage of 90% or more

## CGT concession stakeholder

Significant individual in the company or trust;  
OR

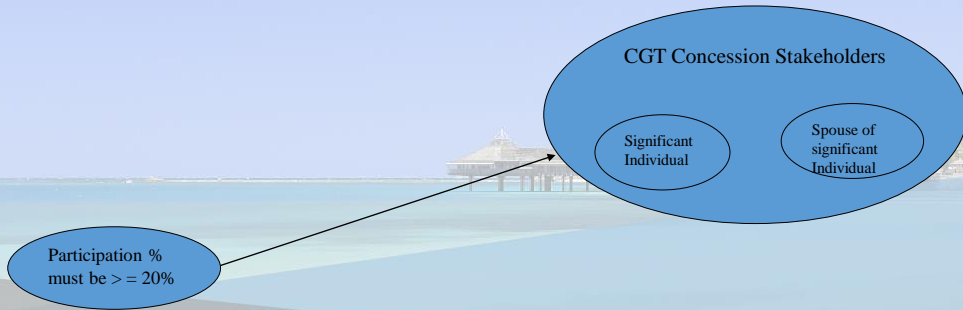
The spouse of a significant individual in the company or trust

## Calculating small business participation percentage

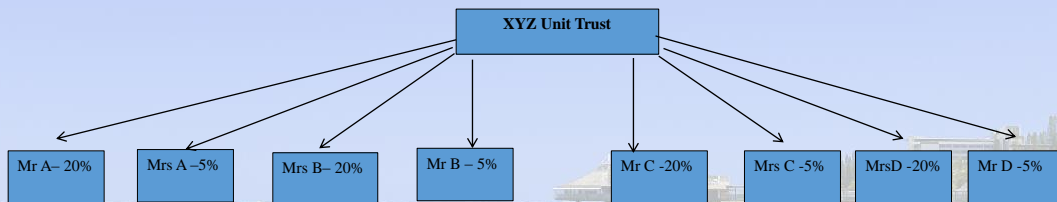
Consider both the direct & indirect participation percentages: sec 152-65

## CGT Small Business Concessions (continued)

- Significant individual's are a subset of the concession stakeholders



## CGT Small Business Concessions (continued)



8 concession stakeholders

## Small business CGT concessions

15 year asset exemption

- Has priority over the other concessions

50% reduction

- Can choose not to apply
- Additional to the general CGT discount available to some taxpayers

Retirement exemption

- Capped to \$500,000 lifetime limit

Rollover relief

- Can be applied before the retirement exemption
- Defers capital gains

## 15 year asset exemption: conditions

The CGT asset is owned continually for at least 15 years

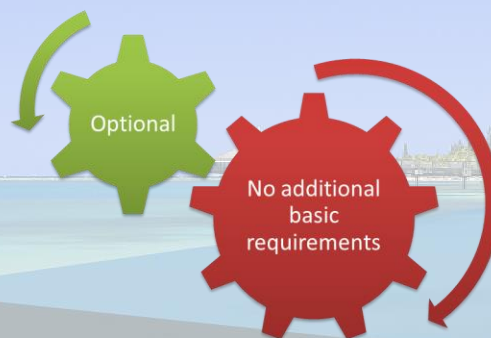
The CGT asset is owned by the individual, or a company or trust that has a significant individual for at least 15 years; and

The individual is 55 years old or over & the CGT event happened in connection with retirement or permanent incapacity

## Distribution of the 15-year CGT asset exemption amount

- Must make the payment within 2 years of the CGT event
- Made to a CGT concession stakeholder
- Must not exceed a certain amount
- Not classified as a dividend
- Does not erode the cost base
- Not included in the assessable income

## 50% reduction



## Small business retirement concession

Capped to a \$500,000 lifetime limit

Can further reduce or eliminate a capital gain

Capital proceeds from the CGT asset must be used for retirement (actual retirement not required)

## Retirement exemption eligibility conditions

CGT events J2, J5  
& J6

Contribution  
requirement for  
individuals less  
than 55 years of  
age

Individuals aged  
55 and over are  
not required to  
make this  
payment

Payment  
requirements for  
CGT concession  
stakeholders of  
companies &  
trusts

## Small business CGT rollover relief

Allows a taxpayer to roll over the capital gain

Does not apply where the 15 year asset exemption applies

50% reduction applies before rollover relief, although the taxpayer can choose not to apply the 50% reduction

May be applied in conjunction with the small business retirement exemption

## Eligibility conditions

Replacement asset

Must be an active asset



## Consequences of rollover relief

Capital gain is disregarded:

to the extent that it does not exceed the cost base of the replacement asset

Crystallisation of the gain:

Where no replacement asset acquired (J5)

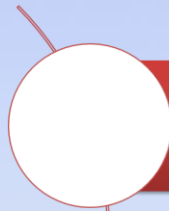
Where replacement asset changes status (J2)

## Where no replacement asset acquired CGT event J5

Deemed capital gain arises

The capital gain may be eligible for the small business retirement exemption

## Where the replacement asset changes its status: CGT event J2



The replacement asset stops being an active asset: e.g. the taxpayer disposes of the asset or stops using it in their business



The replacement asset becomes trading stock

## Proposed Measures - Small business entities

- There are special rules for determining the income or loss of small business entities. They qualify for various concessions that can affect the final figures.
- An entity will be a “small business entity” if it:
  - carries on a business, and
  - satisfies the \$2m aggregated annual turnover test.
- In the May 2016 Budget, the Government announced that the small business entity threshold is to increase from \$2m to \$10m from 1 July 2016.
- For the year ended 30 June 2016, the tax rate for corporate small business entities is 28.5% but is also proposed to be decreased to 27.5% initially and then eventually to 25% for all companies.
- For the year ended 30 June 2016, a small business tax offset is available to individuals who are small business entities, individuals who are a partner in a partnership that is a small business entity, and individuals who are a beneficiary of a trust that is a small business entity. It is 5% of the tax on total small business income (except from companies) capped at \$1,000.

# Tax Update – 2016

## 2016 Federal Budget Measures

### Increasing the small business entity turnover threshold

- The Government will increase the small business entity turnover threshold from \$2 million to \$10 million from 1 July 2016.
- The current \$2 million threshold will be retained for access to the small business CGT concessions.
- The eligibility threshold for the unincorporated small business tax discount will be raised to \$5 million.

## Small business threshold to increase to \$10m

- As a result of the Government's proposal, a business with an aggregated annual turnover of less than \$10m will be able to access a number of small business tax concessions from 1 July 2016

## Small business threshold to increase to \$10m

These include:

- the reduced company tax rate for incorporated small businesses
- the simplified depreciation rules, including immediate tax deductibility for asset purchases costing less than \$20,000 until 30 June 2017
- the simplified trading stock rules
- immediate deductibility for various start-up costs
- a 12-month prepayment rule

## Small business threshold to increase to \$10m

Unfortunately, the \$2 million turnover threshold will be kept for access to the small business CGT concessions.

Also note the different threshold for access to the tax offset

# Tax Update – 2016

## 2016 Federal Budget Measures

### Increasing the unincorporated small business tax discount

- The Government will increase the tax discount for unincorporated small businesses incrementally from the current 5% to 16% over 10 years, from 2016-17 to 2026-27.

The timeframe for the progressive increase in the rate of the unincorporated small business tax discount:

The 10-year implementation of the discount increase will coincide with the 10 years of staggered cuts in the corporate tax rate to 25%.

5%		8%								10%	13%	16%
2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27 and later

# Tax Update – 2016

## 2016 Federal Budget Measures

### Increasing the unincorporated small business tax discount

- The current cap of \$1,000 per individual for each income year will be retained.
- The retention of the \$1,000 cap will place restrictions on individuals being able to fully utilise the discount as the rate incrementally increases to 16%.
- The discount is available to individual taxpayers with business income from an unincorporated small business entity.
- Currently the aggregated turnover threshold of the small business is \$2 million.
- The Government intends to increase this threshold to \$5 million.

## Increase in small business tax offset

- In the May 2016 Budget, the Government announced that with effect from 1 July 2016, the discount would be available for individual taxpayers with business income from an unincorporated business that had an aggregated annual turnover of less than \$5m ie. an increase in the threshold from \$2m to \$5m.
- The Government also announced that with effect from 1 July 2016, the discount would be increased from 5% to 8%, capped at \$1,000

## Small business tax offset

- The tax offset is available to individuals who are small business entities, individuals who are a partner in a partnership that is a small business entity, and individuals (not minors) who are a beneficiary of a trust that is a small business entity

# Tax Update – 2016

## 2016 Federal Budget Measures

### Reducing the company tax rate to 25%

- Government will reduce the company tax rate to 25% over 10 years
- The rate will firstly be reduced to 27.5%, and then it will be reduced progressively to 25% in 2026-27.

The initial 27.5% rate will be implemented progressively from 2016-17 to 2022-23 based on the company's annual aggregated turnover:

Annual aggregated turnover threshold	Income year in which the 27.5% rate will apply
Less than \$10 million	2016-17
\$25 million	2017-18
\$50 million	2018-19
\$100 million	2019-20
\$250 million	2020-21
\$500 million	2021-22
\$1 billion	2022-23

# Tax Update – 2016

## 2016 Federal Budget Measures

### Reducing the company tax rate to 25%

- Government will reduce the company tax rate to 25% over 10 years.
- Once all companies are at a rate of 27.5%, the rate will be progressively reduced to 25% in 2026-27:

Income year	Tax rate
2022-23	27.5%
2023-24	27.5%
2024-25	27%
2025-26	26%
2026-27	25%

# Tax Update – 2016

## 2016 Federal Budget Measures

### Reducing the company tax rate to 25%

- Government will reduce the company tax rate to 25% over 10 years.
- Dividends will be frankable in line with the rate of tax paid by the company.
- This is a departure from last year's small business company tax rate cut, under which eligible small business companies could frank to 30% despite the rate reduction to 28.5%.
- Given that Australia has a dividend imputation system, any additional tax is borne by the shareholder at their personal marginal rate.

# Small business entities

## Immediate deductibility for professional expenses re start-ups

- With effect 1 July 2015, small business entities and individuals are able to immediately deduct certain costs incurred when starting up a business,
- Expenditure that would be deductible over five years under [s 40-880 ITAA 1997](#) is fully deductible in the income year in which the expenditure is incurred if the expenditure:
  - relates to a business that is proposed to be carried on; and
  - is either:
    - incurred in obtaining advice or services relating to the proposed structure or the proposed operation of the business; or
    - is a payment to an Australian government agency of a fee, tax or charge incurred in relation to setting up the business or establishing its operating structure



# New Developments

## Immediate deduction for professional expenses

- Eligible expenses will include fees for:
  - professional advice;
  - accounting advice; and
  - legal advice
- These expenses will no longer be deductible over five years under section 40-880 of the ITAA 1997.

# Small business entities

## Small business restructure rollover relief

- With effect 1 July 2016, the **Tax Laws Amendment (Small Business Restructure Roll-Over) Act 2016** provides Australian resident Small Business Entities ("SBEs") with a new roll-over for gains and losses arising from the transfer of CGT assets, trading stock, revenue assets and depreciating assets
- The roll-over applies if the arrangement is part of a genuine restructure of a small business where the ultimate economic ownership ("UEO") of the asset (directly or indirectly) does not change.

# Small business entities

## Small business restructure rollover relief

- The legislation enables SBEs to disregard any tax gain or loss made on the transfer of their business or assets into the new structures.
- The exclusion does not cover GST or Stamp Duty.
- Where an individual operates as a sole trader, they hold the UEO.
- Where the entity is a company, the provisions will look at the ultimate shareholders to determine the UEO.
- If there is more than one individual who is an ultimate economic owner of an asset, there is an additional requirement that each of those individuals' shares of that ultimate economic ownership be materially unchanged, maintaining the same proportionate ownership in the asset.

# Small business entities

## Small business restructure rollover relief

- The provisions specifically provide for the inclusion of discretionary trusts as an eligible entity type by utilising the existing Family Trust Election ("FTE") rules as a test of the UEO.
- For example, where an individual transfers his/her business to a newly established discretionary trust, the UEO will be deemed not to have changed where the trust has made a FTE and the individual is part of the same family group.
- Exempt entities and complying superannuation funds are excluded.
- This means that assets such as land and buildings cannot be transferred into SMSF even though there may be no change in UEO.
- The roll over relief provides for tax neutral consequences for a transfer by "switching off" the application of the existing income tax law - but only for the purpose of the transfer and not for the purposes of GST, FBT or stamp duty.

## Tax Update - Legislation

### TLA (Small Business Restructure Roll-over) Bill 2016

- In addition to rollover, certain specific consequences for CGT assets:
  - pre-CGT assets will retain their pre-CGT status in the hands of the transferee
  - for purpose of determining whether capital gain may be discounted, transferee is treated as having acquired the CGT asset at the time of the transfer
  - for purpose of determining eligibility for 15 year CGT exemption for small businesses, transferee will be taken as having acquired asset when transferor acquired it.

## Tax Update - Legislation

### TLA (Small Business Restructure Roll-over) Bill 2016

#### Eligibility requirements:

- A small business entity for the income year during which the transfer occurs for CGT assets that are active assets.
- An affiliate of a small business entity for passively held assets that used by the small business entity in its business.
- A connected entity of a small business entity for passively held assets that are used by the small business entity in its business.
- A partner in a partnership that is a small business entity for the income year during which the transfer occurs for passively held assets that are used by the small business entity in its business.
- Both transferor and transferee must be residents of Australia
- For partnerships, at least one partner must be an Australian resident.
- **NOTE – no requirement to meet \$6m NAV test also (only \$2m T/O test)**

# Tax Update - Legislation

## **TLA (Small Business Restructure Roll-over) Bill 2016**

### **Ultimate economic ownership requirement:**

- The small business restructuring transaction must not have effect of changing ultimate economic ownership of transferred assets in a material way.
- Ultimate economic owners of an asset are the individuals who, directly or indirectly, beneficially own an asset.
- Ultimate economic ownership of asset can only be held by natural persons.
- Where a company, partnership or trust owns an asset it will be the natural person owners of the interests in these interposed entities that will ultimately benefit economically from that asset.

# Tax Update - Legislation

## **TLA (Small Business Restructure Roll-over) Bill 2016**

### **Genuine restructure**

**Transaction must be, or part of, a genuine restructure of an ongoing business**

**EM sets out some factors that would indicate a genuine restructure:**

- it is a bona fide commercial arrangement undertaken to enhance business efficiency
- business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership
- transferred assets continue to be used in the business
- restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business
- restructure is not artificial or unduly tax driven; and
- it is not divestment or preliminary step to facilitate economic realisation of assets

## Tax Update - Legislation

### **TLA (Small Business Restructure Roll-over) Bill 2016**

#### **Genuine restructure - safe harbour:**

- Bill provides a safe harbour which deems a SBE to satisfy genuine restructure requirement where, for three years following roll-over:
  - there is no change in ultimate economic ownership of assets of the business (other than trading stock) that were transferred under the transaction
  - those significant assets continue to be active assets; and
  - there is no significant or material use of those significant assets for private purposes.

## Small business entities

### **Example – Small business restructure rollover relief (SBRR)**

- Pep and Sally, a married couple, are directors and shareholders in Vitamin Pty Ltd which has issued two shares.
- Vitamin Pty Ltd carries on a naturopathy business.
- A new discretionary trust, the P&S Trust, is settled and a family trust election is made with Pep as the primary individual.
- On 1 January 2017, Pep and Sally cause Vitamin Pty Ltd to transfer all of its assets (except petty cash) to the trustee of the P&S Trust (the trustee) in consideration for the trustee undertaking to discharge Vitamin Pty Ltd's liabilities.
- The company and the trustee choose to apply the SBRR.

## Small business entities

### **Example – Small business restructure rollover relief (SBRR)**

- As at 1 January 2017, the active assets of the company are:
  - a small consulting room, which was acquired by Vitamin Pty Ltd for \$200,000 in 2010. The market value is \$230,000.
  - a pill pressing machine, with an adjustable value of \$14,000
  - goodwill, which is self-generated, and
  - 50 bottles of homeopathic pills, which became Vitamin Pty Ltd's trading stock during the income year at a cost of \$250.

## Small business entities

### **Example – Small business restructure rollover relief (SBRR)**

- No capital gain or loss arises from the transfer of the consulting room or goodwill.
- The trustee is taken to have acquired the consulting room at the time of the transfer for \$200,000, being Vitamin Pty Ltd's cost base for the asset immediately before the transfer takes effect.

# Small business entities

## Example – Small business restructure rollover relief (SBRR)

- No amount is included in Vitamin Pty Ltd's assessable income, or deduction allowed, as a result of a balancing adjustment event for the transfer of the pill pressing machine.
- The trustee's cost for the pill press is its adjustable value to Vitamin Pty Ltd just before the transfer (\$14,000).
- The trustee can deduct the decline in value of the pill press using the same method and effective life (or remaining effective life, if using the prime cost method) as Vitamin Pty Ltd was using.
- The trustee is taken to have acquired the goodwill at the time of the transfer for \$0, being Vitamin's Pty Ltd's cost base for the goodwill immediately before the transfer takes effect.

# Small business entities

## Example – Small business restructure rollover relief (SBRR)

- As a result of the disposal of the pills to the trustee, Vitamin Pty Ltd is taken to have transferred the pills for their cost (\$250) and not for their market value. Vitamin Pty Ltd includes \$250 in its assessable income under section 70-90.
- The pills are trading stock on hand in the hands of the trustee.
- No dividend arises as a result of the transfer of CGT assets (that are not depreciating assets) by Vitamin Pty Ltd (including any 'deemed dividend' under Division 7A of Part III of the ITAA 1936 or any other provision of the tax law).
- Apart from pre-CGT assets, the transferee acquires the asset at the time of the transfer. That is, the time of acquisition is not altered by Subdivision 328-G.
- Following the transfer of assets to the trustee of the P&S trust, a property investor makes an attractive offer to the trustee for the consulting room.
- On 30 September 2017, the trustee enters into an agreement for the sale of the consulting room.
- Trustee disposes of the room and CGT event A1 happens on 30 September 2017.

# Small business entities

## **Example – Small business restructure rollover relief (SBRR)**

- Trustee is treated as having acquired the CGT asset at the time of the SBRR transfer, on 1 January 2017.
- The trustee is not entitled to access the 50% general CGT discount on disposal, as the trustee acquired the asset less than a year before the CGT event causing this gain.
- However, for the purpose of determining eligibility for the 15 year CGT exemption for small businesses, the transferee will be taken as having acquired the asset when the transferor acquired it.

# New Developments

## **Changes to tax treatment of employee share schemes**

### ***New concession – small start-up companies***

- Most significant reform to be implemented is a tax exemption for discounts on ESS interests acquired in eligible 'small start-up' companies.
- If a **share**, discount is exempt from tax - share is subject to CGT regime, with market value cost base.
- If a **right**, discount is not subject to upfront taxation - right and resulting share once acquired, are subject to CGT regime, with cost base equal to employee's cost of acquiring right.



# New Developments

## Changes to tax treatment of employee share schemes

### *New concession – small start-up companies*

- Company which ESS interest is in – the employer (including its holding company) – must satisfy the following conditions:
- **No equity interests in employer can be listed** on stock or securities exchange at end of year prior acquisition of ESS interest.
- Employer must be company **incorporated less than 10 years** before end of income year prior to when ESS interest acquired.
- Company's **aggregated turnover** for income year prior to income year in which ESS interest was acquired **must not exceed \$50m**.
- The employing company (which may or may not be the company issuing the ESS interest) must be an **Australian tax resident**.

## *Board of Taxation Report - SBEs*

### **Recommendations:**

- Increase the small business entity turnover threshold to at least \$3 million and investigate the feasibility of an increase to \$5 million
- Allow superannuation for employees against quarterly threshold of \$1,350
- Superannuation guarantee charge (SG Charge) should be calculated on the basis of Ordinary Times Earnings (OTE) rather than salary and wages to align it with the way that superannuation contributions are calculated
- SG Charge and any employer contributions paid to a super fund that are used to offset the SG Charge payable be deductible to the employer
- Removing automatic requirement on employers to lodge SG Charge statement with the ATO when they become liable to the SG Charge
- Raise the minor and infrequent FBT threshold from \$300 to \$500
- Aligning the FBT year to the income tax year.

# THANK YOU



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