



SMSF Association National Conference 2019

Workshop: Getting money
into super using the small
business CGT concessions

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The publication has been written by Darren Wynen of Insynt Pty Ltd and is based on the law as stated 5 February 2019.

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Publications

Insynt offers a range of publications aimed at advisers. We will soon be publishing an in-depth guide on the interaction of the small business CGT concessions and superannuation.

Visit the following web address to learn more:

Practical guide to the Small Business CGT Concessions and Super

<https://www.insyt.com.au/publications>

The small business CGT concessions and super – workshop roadmap

During the workshop we will apply the following problem-solving process to various case studies on the small business CGT concessions (SBCs):

- **Step 1** – Ascertain whether the basic conditions are met because these conditions must be satisfied for any small business concession.
- **Step 2** – Know the order that the SBCs, capital losses and CGT discount apply because this affects the amounts to which the concessions can apply, which has a flow-on affect to determining the amount of any net capital gain and the amount that can be contributed to superannuation.
- **Step 3** – Understand how the SBCs work, but in particular – the small business 15-year exemption and the small business retirement exemption (because these the concessions from which superannuation contributions can count towards the CGT cap).
- **Step 4** – Determine how much superannuation can be contributed. Then, ensure that contributions and CGT cap election is made within the required time frames to avoid breaching the contributions cap.
- **Step 5** – Planning ahead for our clients. Understand various strategies that are available to ensure our clients are best-placed to apply the concessions, maximise tax savings and superannuation contributions.

The small business CGT concessions and superannuation

Introduction

With the contributions landscape being turned on its head from 1 July 2017, the CGT cap presents an ideal opportunity for clients to boost their superannuation savings. However, a combination of the complexity of the conditions to access the concessions and the one-off nature of selling a business means that it is often difficult to clearly identify and assess opportunities to boosting superannuation using the CGT cap.

This workshop will review the various strategies available for maximising the CGT cap, common mistakes made when determining eligibility to the concessions and whether the CGT cap trumps buying business premises using an SMSF.

What are the ‘small business CGT concessions’?

The small business CGT concessions outlined in Division 152 of the ITAA 1997 are outlined in the table below:

Concession	Description
The small business 15-year exemption	Any capital gain or loss is disregarded if the entity has continuously owned the asset for more than 15 years and the event happens in connection with the permanent incapacity or retirement of an individual aged at least 55.
Small business 50% active asset reduction	Provides for a 50% reduction of a capital gain where the basic conditions are satisfied (optional).
Small business retirement exemption	Exempts a capital gain up to a lifetime (unindexed) limit of \$500,000 per eligible individual. However, the exempt amount must be paid into a complying superannuation fund if the relevant individual is under 55 at the time of making the choice.
Small business rollover	Defers a capital gain for a minimum of two years where no replacement asset is acquired. The capital gain can be deferred for a longer period of time if a replacement asset is acquired, or a capital improvement is made to an existing asset.

The CGT cap

From a superannuation perspective, the concessions are unique in that they have a dedicated contribution cap called the ‘CGT cap’ – which operates in addition to the concessional and non-concessional contributions cap. The CGT cap amount is \$1.48 million for the 2019 income year.

Hence, the benefits of the concessions are potentially two-fold—the tax savings because the concessions can reduce the capital gain (and therefore any attendant tax liability) they reduce the capital gain and also allow the small business operators to boost their retirement savings through applying the CGT cap.

However, the reality is that the conditions and timing rules can be challenging to navigate. In this paper, we discuss various issues relevant to both accessing the concessions and contributing to superannuation.

2. What are the basic conditions?

The basic conditions are required to be met for all SBCs, and they are broadly summarised below:

Item	Description
<p>Scenario 1 – Business operator sells an asset (e.g., goodwill)</p>	<p>Condition 1 – Must be small The business operator must meet one of the following:</p> <ul style="list-style-type: none"> • Be a CGT small business entity with aggregated turnover below \$2 million (year of CGT event); or • Satisfy the \$6 million maximum net asset value test (just before the CGT event); or • For a partnership asset, this requirement is met if the partnership itself is a CGT small business entity (year of CGT event). <p>Condition 2 – Active asset test</p> <ul style="list-style-type: none"> • The asset satisfies the active asset test (see below).
<p>Scenario 2 – Passive entity sells the asset and used by a ‘connected entity’ that carries on business</p>	<p>Condition 1 – Must be small One of the following conditions must be met:</p> <ul style="list-style-type: none"> • Asset owner – satisfies the \$6 million maximum net asset value test (just before the CGT event); or • Business entity – must be a CGT small business entity in the year that the CGT event occurs; or • For an asset that is not a partnership asset, but used by the partnership, the partnership itself must be a CGT small business entity (year of CGT event). <p>Condition 2 – Active asset test The asset satisfies the ‘active asset test’ (see below).</p> <p>WARNING – Business real property owned by an SMSF cannot be an active asset – even if a ‘related entity’ uses the asset. Refer to TD 2006/68.</p>
<p>Shares or interests in a trust (CGT events occurring from 8 February 2018)</p>	<p>Changes were made to the rules. Broadly, the conditions require that:</p> <p>Stakeholder test</p> <ul style="list-style-type: none"> • Either: <ul style="list-style-type: none"> – The taxpayer (i.e., entity selling the shares) must be a CGT concession stakeholder in the object entity; or – Broadly, entities that are CGT concession stakeholders in the object entity have small business participation percentages totalling at least 90 per cent in the taxpayer;

	<p>Shareholder or unitholder must be small</p> <ul style="list-style-type: none"> unless the taxpayer satisfies the maximum net asset value test, the taxpayer must have carried on a business just prior to the CGT event; <p>Object entity must be small</p> <ul style="list-style-type: none"> the object entity must be a CGT small business entity for the income year or satisfy the maximum net asset value test; and <p>Modified active asset test</p> <p>the shares or interests in the object entity must satisfy a modified active asset test that looks through shares in companies and interests in trusts to the activities and assets of the underlying entities.</p>
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What is the 'active asset test?'

Broadly, an entity will meet the 'active asset test' if the conditions set out in the table below are met:

Ownership period	Time required to be active
Asset owned for more than 15 years	The asset was an active asset for at least 7.5 years during the test period.
Asset owned for 15 years or less	The asset was an active asset for at least half of the test period.

The test begins when the asset is acquired and ends when the CGT event occurs (but can end earlier if the business ceases 12 months before sale).

Modified active asset test for shares

For the lesser of seven and a half years or at least half the period a taxpayer has held the share or interest at least 80 per cent of the sum of the:

- total market value of the assets of the object entity (disregarding any shares in companies or interests in trusts); and
- total market value of the assets of any entity (a later entity) in which the object entity had a small business participation percentage of greater than zero, multiplied by that percentage

must have related to assets that are:

- active assets (modifications apply); or
- cash or financial instruments that are inherently connected with a business carried on by the object entity or a later entity.

Changes were made to this test, with effect for CGT events occurring from 8 February 2018. Discussion of the changes are beyond the scope of this paper. If you would like a summary of the changes (no charge), email me at darren@Insyt.com.au.

What is an 'active asset'?

The following table summarises which assets are active assets, and which ones are not:

These assets are active	These assets are not active
The asset is used or held ready for use in a business carried on (whether alone or in partnership) by the entity, a connected entity or affiliate.	Shares or units, other than those that satisfy the rules above.
An intangible asset (such as goodwill) that is inherently connected with a business carried on by the entity, a connected entity or affiliate.	Financial instruments, such as bank accounts, loans, debentures, bonds, futures and other contracts and share options.
	An asset whose main use is to derive interest, an annuity, rent (except if the rental was only temporary) or foreign exchange gains. This means that a commercial property rented to external parties cannot be an active asset because (even though it may be 'business real property' for superannuation purposes).
	Assets that are not used in a business.

Note the meaning of the following terms (referred to in the table above):

- **Connected entity:** control of unit trust, partnership, company or trust – 40% common control or asset owner has 40% of business entity (or vice versa). For a discretionary trust, an entity is connected if they received at least a 40% distribution of income or capital in any of 4 income years before CGT event year; and
- **Affiliate** – individual or company only who acts in accordance with directions or wishes or in concert with you. Hence, trusts, partnerships and superannuation funds cannot be affiliates. Modifications can allow a spouse or child to be treated as an affiliate.

EXAMPLE– No active asset (Adapted from the ATO's CGT Guide)

Rachael 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 mainly (only) used by Rachael to derive rent. It is irrelevant whether Rachael's activities constitute a business.

1. CGT – order of applying the concessions

An important consideration is to determine how the concessions apply.

Step	Description
First step – Determine whether the small business 15-year exemption applies	The small business 15-year exemption applies before: <ul style="list-style-type: none">• capital losses;• the CGT discount; and• the small business retirement exemption and the small business rollover.
Second step – apply any capital losses	If the small business 15-year exemption does not apply, any current year or prior year capital losses are applied against the capital gain.
Third step – apply the CGT discount (if applicable)	Any remaining capital gain is then reduced by the CGT discount, if applicable.
Fourth step – apply the 50% active asset exemption, if chosen	After applying the CGT discount, reduce any remaining capital gain by the 50% active asset reduction (if chosen and if eligible). Note, it is not compulsory to apply the small business 50% active asset reduction.
Fifth step – apply the small business retirement exemption and/or the small business rollover	Finally, the retirement exemption and/or the small business rollover can be applied to any remaining capital gain.

3. The CGT cap

The small business CGT concessions relevant to contributing to superannuation are:

- The small business 15-year exemption; and
- The small business retirement exemption.

Qualifying amounts contributed under these concessions can count towards the CGT cap. The CGT cap allows individuals who make a written eligible choice to exclude the non-concessional contributions from the NCC cap and count it against a separate CGT cap instead (\$1.48 million for the 2019 income year).

The benefits of the CGT cap are:

- The contribution is not limited by the individual's total superannuation balance.
- The CGT cap can be used in conjunction with the individual's concessional and non-concessional caps.
- With regards to the 15-year exemption, some amounts can still count towards the cap even though they don't technically qualify for the 15-year exemption (e.g., because the asset is pre-CGT, no capital gain or loss was made or the asset was sold before 15 years elapsed due to the member's permanent incapacity).

Note that application of the CGT cap requires an active choice to be made by the individual, and the choice must be provided to the fund trustee on or before the time of the contribution being made. It does not have to be lodged with the ATO.

The CGT cap election is available from the ATO's website at:

<https://www.ato.gov.au/forms/cgt-cap-election/>

<https://www.ato.gov.au/uploadedFiles/Content/SPR/downloads/SPR19584n71161.pdf>

Further, contributions that count towards the CGT cap are not exempt from satisfying the requirements under Reg 7.04. This means, for example, that a taxpayer aged 76 will cannot contribute a small business amount to super (i.e., because the fund cannot accept the contribution).

It is also important to note that a contribution must be a non-concessional contribution to count towards the CGT cap. This means that a CGT cap election cannot be made in respect of an in specie asset transfer directly from a company or trust to an SMSF. The ATO discusses this requirement in Private Binding Ruling Authorisation Number: [1051375303617](#).

EXAMPLE—Importance of the election

During the 2019 income year Sam, aged 62, sells a business he owns for \$900,000 and applies the 15-year exemption. He contributes the proceeds of \$900,000 to his superannuation fund in the same year. During the same year he also contributes non-concessional contributions of \$200,000. Sam's total NCC made during the 2019 income year are \$1.1m. The \$900,000 proceeds are counted against his NCC cap unless he makes the CGT cap election. If he does not elect, he will have excess NCC.

What are the main requirements need to be met to qualify for the 15-year exemption?

Broadly, the conditions that must be met are set below.

Conditions	Description
Basic conditions	The basic conditions outlined above must be met.
Ownership	The asset must be owned continuously for 15 years ending just before the time of the CGT event. If the shareholders or unitholders are selling, the ownership requirement must be met by each shareholder or unitholder.
Additional conditions for an individual	<p>Individual selling a business asset (e.g., land, goodwill) When the CGT event happened</p> <ul style="list-style-type: none"> • They were permanently incapacitated, or • They were 55 years old or older, and the event happened in connection with their retirement. <p>Individual selling shares or units The company or trust must have had a significant individual for periods totalling at least 15 years during the time the share or interest was owned for, even if it was not the same significant individual during the whole period.</p>
Additional conditions for a company or trust	<p>Significant individual requirement The company or trust had a significant individual for a total of at least 15 years of the whole period of ownership (even if it was not the same significant individual during the whole period); and The individual who was a significant individual just before the CGT event was:</p> <ul style="list-style-type: none"> • At least 55 years old at that time and the event happened in connection with their retirement, or • Was permanently incapacitated at that time.

What are the consequences of applying the 15-year exemption in a company or trust?

The capital will be completely disregarded. The benefit of the 15-year exemption is that the disregarded capital gain (not the whole proceeds) can be passed out of a unit trust or company in a tax free manner, provided it is paid within two years of the CGT event.

However, this is conditional on:

- The payment being made to an individual who was a CGT concession stakeholder of the company or trust just before the CGT event, and
- The total payments made to each CGT concession stakeholder must not exceed an amount determined by multiplying the CGT concession stakeholder's control percentage by the exempt amount.

When does the amount have to be contributed to super to count towards the CGT cap (15-year exemption)?

Section 292-100 provides the following time frames for the 15-year exemption:

Item	Description
Individual sells the asset	The contribution is made on or before the later of the following days: <ul style="list-style-type: none"> the day the individual is required to lodge their income tax return for the income year in which the CGT event happened; 30 days after the day the capital proceeds are received.
Company or trust sells the asset	Generally, provided the entity makes the payment to the stakeholder within two years, the contribution must be made within 30 days of the payment being received.
Both of the above situations	Written election to be given to the superannuation fund on or before the time of the contribution being made.

Superannuation planning with the 15-year exemption

The following planning points should be noted with the 15-year exemption:

Item	Description
Applies before capital losses	The 15-year exemption applies before capital losses – providing an opportunity to maximise superannuation contributions, whilst retaining capital losses.
If company or trust sells an asset – only one stakeholder needs to be 55+ and retire	If a company or trust sells the asset, all stakeholders can potentially benefit from the exemption – not just the person aged at least 55 for whom the event happens in connection with their retirement. However, if each shareholder or unitholder sells – they must each satisfy the requirement to be 55 and retire (or be permanently incapacitated).
Proceeds count towards CGT cap (not just the disregarded gain)	The proceeds can count towards the CGT cap. This can be problematic with a company or trust – assume a company or trust buys an asset for \$200,000 and sells it for \$1m. This means that: <ul style="list-style-type: none"> The exempt amount of \$800,000 can potentially be contributed to superannuation and applied against the CGT cap; and The \$200,000 (i.e., that relates to the asset's cost base) can also be counted against the CGT cap, but it cannot be accessed tax-free from the company. It may, for example, be paid out of the company as a taxable dividend.

What are the main requirements need to be met to qualify for the retirement exemption?

Broadly, the conditions that must be met are set out in the table below. Also note the following:

- The timing of the ‘choice’ is generally the day that the tax return is lodged for the year in which the CGT event occurred;
- Although it is called the ‘retirement exemption’, it is not a condition of the concession to retire; and
- A written choice must be made (i.e., in addition to the CGT cap election, if applicable) of the CGT exempt amount. Email me darren@insyt.com.au if you would like a sample.

Item	Description
Basic conditions	The basic conditions outlined above must be met.
Additional conditions for individual	<ul style="list-style-type: none"> • A written record is kept of the amount the individual chose to disregard (the CGT exempt amount). • The individual makes a personal contribution equal to the exempt amount to a superannuation fund if they are under 55 years old just before the choice is made.
Additional conditions for a company or trust	<p>The company or trust:</p> <ul style="list-style-type: none"> • Satisfies the significant individual test; • Keeps a written record of the amount it chooses to disregard (the exempt amount). The company is generally free to choose how the exempt amount is allocated. • Makes payment to at least one of your CGT concession stakeholders worked out by reference to each individual’s percentage of the exempt amount. • The payment is equal to the exempt amount or the amount of capital proceeds, whichever is less, and • If the capital proceeds are received in instalments, the company or trust must make a payment to a CGT concession stakeholder for each instalment in succession (up to the asset’s CGT exempt amount). <p>When must the payment be made from the company? Generally, by the later of:</p> <ul style="list-style-type: none"> • seven days after the company or trust chooses to disregard the capital gain, and • seven days after the company or trust receives the capital proceeds from the CGT event. <p>However, if the retirement exemption is chosen for a J2, J5 or J6 event – seven days after the company or trust chooses to disregard the capital gain.</p> <p>Note, if the individual is under 55 just before a payment is made:</p> <ul style="list-style-type: none"> • The amount must be paid to a complying fund; and • The company or trust must notify the fund that it has been made in accordance with S.152-325 of the ITAA 1997.

When does the amount have to be contributed to super to count towards the CGT cap (retirement exemption)?

Section 292-100 provides the following time frames for the retirement exemption:

Item	Description
Individual sells the asset	The contribution is made on or before the later of the following days: <ul style="list-style-type: none">the day the individual is required to lodge their income tax return for the income year in which the CGT event happened;30 days after the day the capital proceeds are received.
Company sells the asset	Generally, the contribution must be made within 30 days of the payment being received.
Both of the above situations	Written election to be given to the superannuation fund on or before the time of the contribution being made.

Superannuation planning with the retirement exemption

The following planning points should be noted with the retirement exemption:

Item	Description
50% small business reduction	The small business 50% reduction is optional – meaning that the taxpayer can choose not to apply it to maximise the contribution under the retirement exemption.
Small business rollover	For taxpayers nearing 55 who do not wish to contribute to superannuation, they can opt for the small business rollover to automatically defer for two years (no penalty applies).
Assets purchased pre 21 September 1999	The retirement exemption amount can be maximized by choosing the indexation method instead of the general CGT discount.

What are some of the differences between the retirement exemption and the 15-year exemption?

Some of the key differences between the 15-year exemption and the retirement exemption for superannuation planning are:

- **Capital losses** – unlike the 15-year exemption, capital losses apply to reduce capital gain before retirement exemption applies;
- **Higher potential amount with the 15-year exemption** – for the 15-year exemption, the choice can be made up to the amount of capital proceeds received (capped to the CGT cap). In contrast, the retirement exemption is limited to the CGT exempt amount of \$500,000. Therefore, an individual who only benefits from the retirement exemption will never utilise more than \$500,000 of their CGT cap.
- **Flexibility with retirement exemption (company or trust)** – with the retirement exemption, a company or trust selling an asset with multiple stakeholders can choose to allocate the exempt amount amongst its stakeholders, at its discretion. In contrast, the 15-year exemption is essentially fixed per stakeholder. This means that with the retirement exemption:
 - This flexibility can be used to rebalance superannuation between spouses; and
 - The allocation can be changed if one person has used up their retirement exemption amount.

General CGT cap strategies

General CGT cap strategies to consider are:

- For individuals approaching a total superannuation balance of \$1.6 million, it makes sense to boost their non-concessional contributions and defer their CGT cap contributions (i.e., as these contributions are not subject to a total superannuation balance restriction).
- The applicable CGT cap is the year in which the contribution is made. Although the retirement exemption is capped at \$500,000, the indexation in the CGT cap can make a significant difference with the retirement exemption particularly where the payment is being made from a company or trust (i.e., as the entity has two years from the CGT event to make the payment).

References

CGT cap amounts

<https://www.ato.gov.au/Rates/Key-superannuation-rates-and-thresholds/?page=5>

CGT cap election

<https://www.ato.gov.au/forms/cgt-cap-election/>

ATO – Guide to the small business CGT concessions (QC 22165)

<https://www.ato.gov.au/general/capital-gains-tax/small-business-cgt-concessions/>

Insyt – coming soon

Practical guide to the Small Business CGT Concessions and Super

<https://www.insyt.com.au/publications>