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Getting money into super using small business CGT concessions

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Darren Wynen is the founder of Insyt, a company that provides publications, training and consulting services for accountants and financial advisers.

On the teaching side, Darren has been in the tax and accounting field for over 25 years and more specifically, in the training arena for the last 17 years. Darren originally worked for the NTAA for 10 years and also as a writer and trainer for TaxBanter Pty Ltd.

As a writer, Darren has written extensively about SMSFs through his own work, numerous training materials, and his decade-long involvement with the NTAA (including 'Super Schools').

Darren has also assisted with writing and reviewing technical materials for the SMSF Association, including the Association's Trustee Knowledge Centre, SSA program and adviser case studies

Introduction

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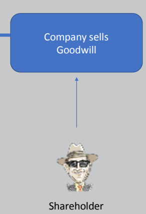
- Small business CGT concessions (SBCs) can reduce or eliminate CGT and boost superannuation
- The workshop provides an overview of concessions and strategies
- Also refer to the accompanying paper

Basic conditions

- The basic conditions must be met for all concessions
- Generally, the vendor must be 'small' and satisfy the 'active asset test'
- Additional conditions apply for shares in a company or units in a trust

- **Scenario 1** – Business operator sells asset

Conditions	Description
Must be small	• CGT small business entity; **or** • Satisfy the $6 m maximum bet asset value test; **or** • Partnership is a CGT small business entity
Active asset test	The asset must meet the active asset test



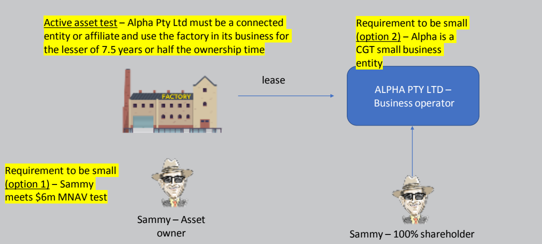
What is an active asset?

Active assets	Not active assets
Shop owned by the business operator	Shares or units (unless the 80% rule is met)
Goodwill owned by the business operator	Work in progress
Factory rented to a 'connected entity'	Factory rented to an unrelated party
	Assets not used in a business
	Plant and equipment, trading stock
	Asset owned by an SMSF

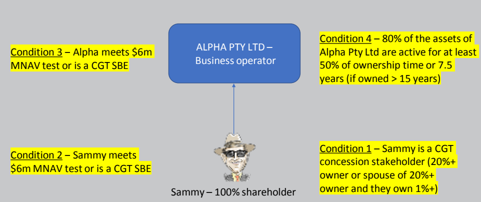
Active asset test

Ownership period	Time required to be active
Asset owned > 15 years	At least 7.5 years
Asset owned =< 15 years	Half of the test period
NB. 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)	

Scenario 2 – Passive entity sells asset

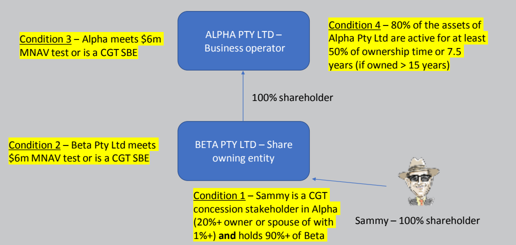


Scenario 3A* – Shares or units sold (individual)



* Slide summarises new rules applying to CGT events occurring on or after 8 February 2018

Scenario 3B – Shares or units sold (entity)



* Slide summarises new rules applying to CGT events occurring on or after 8 February 2018

Ordering of CGT concessions

1. 15-year exemption* STOP
2. Apply capital losses
3. CGT discount (if eligible)
4. Apply the active asset reduction (if chosen)
5. Apply the small business retirement exemption and/or small business rollover

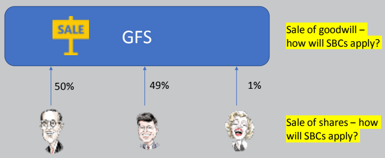
* No need to proceed further if the 15-year exemption applies

Eligibility for concessions

Concession	Some points to note on eligibility
15-year exemption	• Asset must be owned for 15 years • **Individual** – permanent incapacity or retirement and aged 55+ • **Company or trust** – significant significant individual for 15+ years **and** connected with permanent incapacity or retirement of individual aged 55+ • **Company or trust** – payment of disregarded capital gain exempt if paid to CGT concession stakeholder within 2 years of CGT event
Retirement exemption	• Retirement is not necessary • Lifetime cap of $500,000 (unindexed) per individual • **Company or trust** – flexible allocation of exempt amount between CGT concession stakeholders • **All entities** – written election by entity with the CGT event to be kept on file (e.g., the trust makes the election – not the beneficiaries)
Small business 50% reduction	• Not compulsory
Small business rollover	• Results in automatic deferral of a capital gain • Future J events may qualify for retirement exemption (further rollover for J2)

Case Study 1

GFS:
- Established in 1987
- Aggregated turnover of $1.2m
- Market value of $2m



	Joe	Jack	Marilyn
CGT retirement limit	$150,000	$500,000	$500,000
Date shares purchased	1987	2000	2010
Age	85	64	48

Suggested answers – Case study 1

- Yes, small and active asset test met
- 15-year exemption due to Joe’s retirement
- Shareholders, GFS to be small and 80% active asset test
- Yes, she is a spouse of a significant individual
- Joe (Jack if retiring)– 15-year exemption
- Jack, if not retiring and Marilyn – 50% general, 50% active asset reduction, retirement exemption and/or rollover

The CGT Cap

- Individuals have a lifetime, indexed CGT cap ($1.48 million for the 2019 income year)
- Allows non-concessional contributions to be assessed against the CGT cap instead of NCC cap
- Applied against the CGT cap in the contribution year (not when the year of the CGT event)
- SBCs relevant to the CGT cap are the 15-year exemption and the retirement exemption

The CGT Cap – 15-year exemption

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Concession	Some points to note
Choice to apply CGT cap	• Written election to be made and given to fund on or before contribution • Can apply to amounts such as pre-CGT gains
Acceptance rules	• CGT cap amounts are ‘contributions’ for Reg 7.04
15-year exemption (individual sells)	**Amount that can be contributed** • Proceeds (not merely the disregarded capital gain) **Timing of superannuation contribution (CGT cap) - by the later of:** • Due date for tax return lodgment; and • 30 days of receiving proceeds.
15-year exemption (company or trust sells)	**Payment of disregarded gain out of the entity to stakeholders** • Payment must be made by the company or trust to a CGT concession stakeholder within two years to be exempt • Note, only the disregarded capital gain is exempt (not the proceeds) **Timing of superannuation contribution (CGT cap)** • Contribution cannot exceed stakeholder’s proportion of capital proceeds up to payment amount; and • Must be made within 30 days of the payment being received.

Case Study 2

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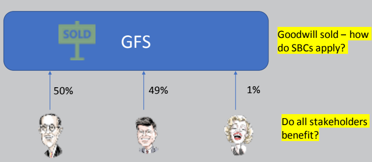
GFS:
- Sale for $1.8 million
- Business started 1987
- Capital gain of $1.8 million
- Signed 1 June 19, settles July 19
- Joe is retiring



	Joe	Jack	Marilyn
CGT retirement limit	$150,000	$500,000	$500,000
CGT cap remaining (‘19 FY)	$1.13 m	$1.48 m	$1.48m
Age	85	64	48

Suggested answers – Case study 2

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- CGT event occurs in the 2019 FY
- No CGT cap contributions for Joe as he is 75+
- **Joe** – Nil, **Jack** – $882,000, **Marilyn** – $18,000. For completeness Jack and Marilyn could contribute $300k NCC + $25k NCC from additional sources
- Irrelevant that they are not 55+ and retiring (GFS only needs one to meet the condition)

Answer – Case study 2

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- If Jack has a TSB of $2m+, CGT cap contributions OK as they are excluded from total super balance restrictions
- Note, one or more payments can be made – consider timing of payments – e.g., $300,000 NCC for Jack and Marilyn in 2019 FY and 15-year exemption amounts in the 2020 FY (subject to Reg 7.04 for Jack)

CGT cap – retirement exemption

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- If the 15-year exemption does not apply, capital losses, CGT discount and active asset reduction can affect
- This is due to the CGT ordering rules (15-year exemption applies at Step 1, retirement exemption at Step 4)

CGT Cap – issues with 50% active asset reduction

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Concession	Some points to note
Compulsory?	• It is not compulsory to apply the small business 50% reduction
Accessing the exempt amount from a discretionary trust	• The exempt amount from the trust applying the active asset reduction can be distributed tax-free to the beneficiaries
Accessing the exempt amount from a company	• The exempt amount can only be accessed tax free on liquidation – refer also to TD 2001/14 • The SBCs may potentially apply to a capital gain made by a shareholder
Accessing the exempt amount from a unit trust	• Distributing the exempt amount to the unitholders reduces the cost base of the units • Any excess triggers CGT event E4 • The SBCs may potentially to a capital gain made by a unitholder

CGT Cap – retirement exemption

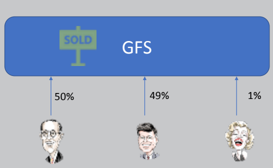
Concession	Some points to note
Choice to apply CGT cap and general comments	• Written election to be given to fund by time of contribution • Capped to $500,000 unindexed per individual (lifetime limit) • Must contribute to super if individual < 55 just before choice
Acceptance rules	• CGT cap amounts are 'contributions' for Reg 7.04 purposes
Retirement exemption (individual sells asset)	**Timing of contribution – by the later of:** • Due date for tax return lodgment; and • 30 days of receiving the proceeds.
Retirement exemption (company or trust sells asset)	**Timing of retirement exemption amount payment from company or trust** Generally, to be made by the later of: • 7 days of choice being made to disregard gain (generally, date of lodging company/trust tax return); and • 7 days of proceeds being received. **Timing of contribution to superannuation** • Within 30 days of payment to a CGT concession stakeholder.

CGT Cap – planning

Concession	Some points to note
Capital losses	• Unlike 15-year exemption, capital losses apply to reduce capital gain before retirement exemption applies
Two-year deferral using the rollover	• For individuals approaching 55 who do not want to contribute to superannuation, the small business rollover can be chosen • No penalty applies for deferring the gain
15-year exemption is the holy grail	• Retirement exemption is limited to $500,000 per individual • In contrast, no limit applies to the 15-year exemption
Retirement exemption	• Consider not applying the 50% reduction for a company to maximise the retirement exemption amount • Consider choosing the indexation method instead of the general CGT discount for assets purchased before 21 September 1999 to maximise the exemption • Where an entity makes the gain, the retirement exemption offers flexibility with choosing the exempt amount amongst the stakeholder (whereas the 15-year exemption is fixed)

Case Study 3

GFS:
- Sale for $1.8 million
- Business started 2009
- Capital gain of $1.8 million
- No capital losses
- Signed 1 June 19, settles July 19
- Joe is retiring



Goodwill sold – how do SBCs apply?

	Joe	Jack	Marilyn
CGT retirement limit	$150,000	$500,000	$500,000
CGT cap remaining ('19 FY)	$1.13 m	$1.48 m	$1.48m
Age	85	64	48

Suggested answers – Case study 3

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- Small business 50% reduction, active asset reduction and retirement exemption/rollover can apply to gain of $1.8m
- If no 50% reduction – $1,150,000 retirement exemption amounts leaves $650,000 taxable (rollover can defer)
- Alternatively, 50% active asset reduction then remaining $900,000 reduced to nil under retirement exemption
- Choice as to how to allocate between stakeholders (up to $500k or $150k for Joe)

Suggested answers – Case study 3

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- Prefer wind-up and shareholders can also benefit from concessions on exempt amount of $900,000
- They can apply 50% general discount, 50% active asset reduction, retirement exemption and/or rollover on cancellation of shares
- E.g., Joe = 50% ownership x $900,000= $450,000 less $225,000 general discount, less $112,500 active asset reduction and any retirement exemption and/or rollover

Active assets and passive entities

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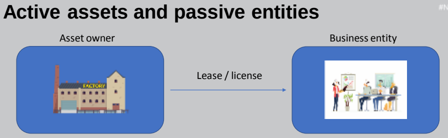
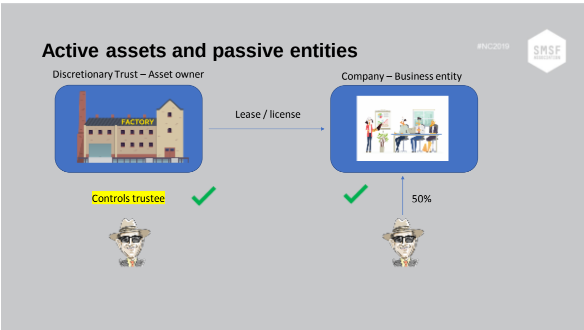


Active asset held by a passive entity must be used by a:

- **Connected entity**: company, unit trust or partnership – 40% control (special rules for discretionary trusts). SMSFs cannot be connected; and
- **Affiliate** – individual or company only who acts in accordance with directions/wishes or in concert (special rules can treat spouse/child <18 as an affiliate)


Active assets and passive entities
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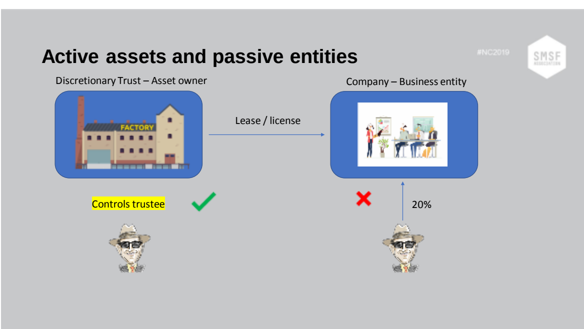
SMSF
Discretionary Trust – Asset owner
Company – Business entity
FACTORY
Lease / license
Controls trustee
50%


Active assets and passive entities
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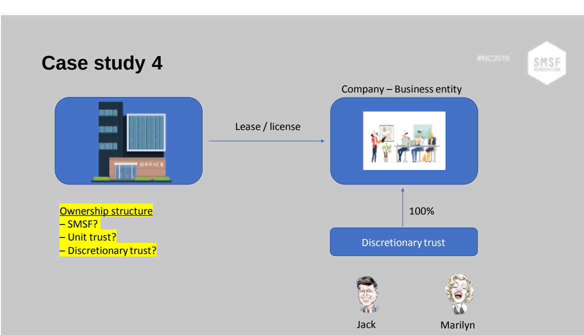
SMSF
Discretionary Trust – Asset owner
Company – Business entity
FACTORY
Lease / license
Controls trustee
20%


Case study 4
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SMSF
Company – Business entity
Lease / license
OFFICE
Ownership structure
– SMSF?
– Unit trust?
– Discretionary trust?
100%
Discretionary trust
Jack
Marilyn

Case study 4 – issues to consider

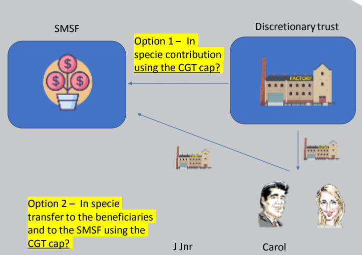
Issue	Description
Availability of the SBCs	• SMSFs cannot apply the small business CGT concessions • Will the business continue to be small?
SBC exemption v pension exemption	• SMSF – income on assets supporting the pension is exempt, whereas the full capital gain may be disregarded outside of the fund
Unit trust	• In-house asset issues • Non-geared trust appropriate? • Unrelated trust possible? • Other investors outside of super can invest, and gear to fund the purchase
Other issues	• Asset protection offered by an SMSF • Will the SBCs and/or pension exemption be watered down in the future? • Taxation unknowns (e.g., taxation of trusts) • Ensure commercial justification in event of ATO challenge

Suggested answers – Case study 4

- Not an active asset if owned by the SMSF
- Yes, e.g., if Jack owns 40% of the unit trust, he will control the company and the unit trust

Case study 5

Factory:
- Bought in 1999
- Cost base of $200,000
- Current MV $1 million



Other options?
- Purchase
- LRBA
- NCC and CC

Option 2 – In specie transfer to the beneficiaries and to the SMSF using the CGT cap?

Case study 5 – issues to consider

Issue	Description
CGT cap contribution directly from the trust	• Cannot be a concessional contribution • Will the direct transfer create a problem?
Is the 15-year exemption available?	• The trust has owned the asset for 15 years, but will can it apply the 15 year exemption?
Can the indexation method be applied?	• If the asset was acquired before 21 September 1999, the indexation method can apply which increases the capital gain
In specie transfer to Carol and J Jr	• If the asset is transferred in specie from the trust to Carol and J Jr, and the retirement exemption is applied – a separate payment must be made
Transfer of the property under the CGT cap	• ATO ID 2010/217 permits a separate transfer of property instead of money to satisfy the retirement exemption
Funding	• How should the available cash reserves be used?
State taxes	• Stamp duty is a consideration, and this varies from State to State.

SBCs and Super

Coming soon – a comprehensive guide for advisers, written in an easy-to-follow format :

Practical guide to the Small Business CGT Concessions and Super
https://www.insyt.com.au/publications

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