THE SMALL BUSINESS CGT CONCESSIONS AND SUPER – THE PRACTICAL ASPECTS

Darren Wynen, Director, Insyt Pty Ltd

#NC2020

Darren Wynen

Director, Insyt Pty Ltd

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 worked as a writer and trainer for the NTAA for over 10 years, and TaxBanter for 5 years. More recently, he co-presented Super Schools 2019 Day 1 and Day 2 for the NTAA. In addition, Darren provides tax and super training for advisers through his company, Insyt. As a writer, Darren has written extensively about SMSFs and tax through his own work, training materials, and his involvement with the NTAA and TaxBanter. He has also released numerous publications on the small business CGT concessions, transitional CGT relief, SMSFs and tax. 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.

The Small Business CGT Concessions – The practical aspects

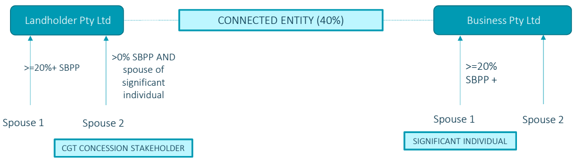
Introduction

- Terminology
- The small business CGT concessions
- The CGT Cap
- Pulling it all together – Case studies
- Common Q & A

WARNING–The government recently released a report by the Board of Taxation. Within that report, the BOT recommended that the existing SBCs be reformed – with the 15-year exemption, active asset reduction and retirement exemption being replaced with one CGT exemption (subject to a cap). The government has not responded to the report.

The Small Business CGT Concessions – The practical aspects

Terminology



AFFILIATE– individual or company only who acts in accordance with directions/wishes or in concert and that carries on a business (special rules can treat spouse/child <18 as an affiliate)
SBPP (small business participation percentage) – An entity's small business participation percentage in another entity at a time is the sum of:
- The entity's direct small business participation percentage in the other entity at that time
- The entity's indirect small business participation percentage in the other entity at that time.

The Small Business CGT Concessions – The practical aspects

The small business CGT concessions

Concession	Description
The small business 15- year exemption – can count towards CGT cap	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 – can count towards CGT Cap	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.

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The SBCs and superannuation

- Contributing to superannuation is unique in that both of the following must be addressed:

  A. **Tax** – assess whether their client is eligible for the small business CGT concessions (SBCs) under Division 152; and

  B. **Superannuation** – ensure that the receiving superannuation fund can accept the CGT cap contribution, and that the contributing individual meets the eligibility criteria for the CGT cap.

The Small Business CGT Concessions – The practical aspects

A suggested approach

Item	Description
	Reviewing the tax aspects of the SBCs
Step 1 – Determine if the basic conditions are met	Check whether the taxpayer satisfies the basic conditions in S.152-10 (i.e., because access to any SBC is subject to these conditions being met).
Step 2 – Review the CGT ordering rules	Know the order that the SBCs, capital losses and general 50% CGT discount apply (S.102-5) because this impacts on the capital gain amount that is disregarded under the 15-year and retirement exemption. In turn, this determines the level of any superannuation contributions that can be covered by the CGT cap instead of the non-concessional contributions cap.
Step 3 – Determine whether the taxpayer qualifies for the SBCs	Work out: • Which of the SBCs the taxpayer might qualify for; • Whether the taxpayer satisfies the conditions required to access the specific concession; and • Whether it serves the taxpayer to apply the particular concession/s. For example, the taxpayer may ignore the 50% active asset reduction to maximise the contributions to superannuation under the CGT cap.

The Small Business CGT Concessions – The practical aspects

A suggested approach

Item	Description
	Review the superannuation aspects of the SBCs
Step 4 – Check the acceptance rules	Stakeholders seeking to make superannuation contributions using the CGT and/or other contribution caps must check that the fund can accept the contribution (e.g., that the acceptance rules in Reg 7.04 of the SIS Regs 1994 are met).
Step 5 – Review whether the 15-year or retirement exemption applies and obtain the individual's total superannuation balance (if making NCCs)	Check whether the taxpayer will contribute under the small business 15-year exemption or the small business retirement exemption, and whether the individual will make any additional superannuation contributions (e.g., using the non-concessional contributions cap). Obtain all stakeholder's total superannuation balances as at 30 June if they intend on making non-concessional contributions. Check the payment and timing requirements for the contribution.
Step 6 – Determine the level of superannuation contributions	From Step 5, work out the level of superannuation contributions and type that the taxpayer and/or the individual/s are planning to make. Then, ensure that the superannuation fund receives the contributions, and any required CGT cap elections, within the applicable time limits.

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Summary of basic conditions

'Small' → 'Active asset test' → Shares or units → Additional conditions apply

Description
CGT small business entity *
$6 million MNAV test

* Test only available to a business with turnover < $2m, Partnership is a CGT SBE or connected entity/affiliate that uses asset is a CGT SBE. SBE aggregated turnover to be below $2m.

The Small Business CGT Concessions – The practical aspects

Case study 1 – The 15-year exemption

- The Royal Unit Trust is owned by two family discretionary trusts. The unit trust is a CGT small business entity, which has carried on business for the last 20 years.
- Camilla (aged 62) and Charles (aged 67) control one discretionary trust, whilst William (aged 38) and Catherine (aged 38) control the other discretionary trust. The discretionary trusts generally distribute to bucket companies, which are owned by on a 50/50 basis by Camilla and Charles, and William and Catherine respectively.
- A contract was entered into on 3 March 2020 to sell the goodwill and land from which the business was conducted. Assume that settlement occurs on 5 May 2020. The sale is happening in connection with Charles' retirement. Kate and William do not wish to contribute to superannuation.

The Small Business CGT Concessions – The practical aspects

Case study – the 15-year exemption

- Details of the capital gain made on each asset are set out below:

Asset	Date of purchase	Asset cost base	Consideration received	Capital gain
Land	1998	$150,000	$1,100,000	$950,000
Goodwill	1998	Nil	$1,000,000	$1,000,000
Total		$150,000	$2,100,000	$1,950,000

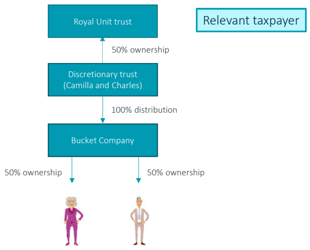
The Small Business CGT Concessions – The practical aspects

Case study 1 – checking the tax aspects

Item	Description
Reviewing the tax aspects of the SBCs	
Step 1 – Determine if the basic conditions are met	The Royal Unit Trust must satisfy the basic conditions. • Assume the Royal Unit Trust is a CGT small business entity. • Assume the active asset test is met for the goodwill and the land. Therefore, this condition is met.
Step 2 – Review the CGT ordering rules	The 15-year exemption applies before any capital losses. If the conditions are met, the capital gain can be disregarded in full.
Step 3 – Determine whether the taxpayer qualifies for the 15-year exemption	• The Royal Unit 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: ▪ At least 55 years old at that time and the event happened in connection with their retirement, or ▪ Was permanently incapacitated at that time.

The Small Business CGT Concessions – The practical aspects

Case study 1



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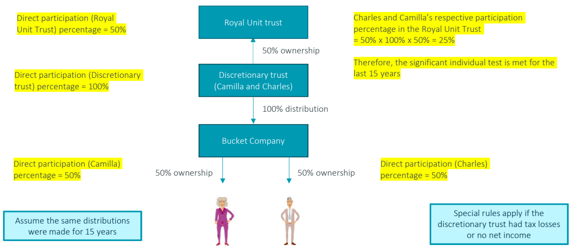
Case study 1 – 15 year exemption (significant individual test)

- A significant individual of a company or trust if they have a small business participation percentage of at least 20% which is made up of the following:
  A. The direct small business participation percentage; and
  B. The indirect small business participation percentage.

INFO–Charles and Camilla do not have any direct ownership interest in the Royal Unit Trust. Therefore, we need to work out their indirect small business participation percentages. An entity's indirect small business participation percentage in a company or trust is the entity's direct participation percentage in an interposed entity multiplied by the interposed entity's total participation percentage (both direct and indirect) in the company or trust.

The Small Business CGT Concessions – The practical aspects

Case study 1 – Significant individual test



The Small Business CGT Concessions – The practical aspects

Case study 1 – Significant individual just before the CGT event?

- In determining the small business participation percentages to work out whether the Royal Unit Trust has a significant individual 'just before' the CGT event (3 March 2020):
  - **Company** – 50% (Camilla and Charles ownership percentage).
  - **Discretionary trust** – this is based on the income and capital distributions to beneficiaries made up to and including 30 June 2020 (if different – take the lower of the two). Assuming that no distributions of capital are made, and the discretionary trust makes the company presently entitled to all of its net income – the company's direct participation interest in the discretionary trust is 100%.
  - **Royal Unit Trust** – assuming that the unit trust is a 'fixed trust', and that the discretionary trust has equal entitlements to income and capital – the discretionary trust has an ownership interest of 50% in the unit trust just before the CGT event.
- Therefore, the Royal Unit Trust has a significant individual (Charles or Camilla) just before the CGT event – as they have a small business participation percentage of 25% (50% x 100% x 50%)

The Small Business CGT Concessions – The practical aspects

Case study 1 – reviewing the super aspects

Item	Description
	Review the superannuation aspects of the SBCs
Step 4 – Check the acceptance rules	Stakeholders seeking to make superannuation contributions using the CGT and/or other contribution caps must check that the fund can accept the contribution (e.g., that the acceptance rules in Reg 7.04 of the SIS Regs 1994 are met). **This could potentially be an issue for Charles – timing of the exempt payment from the Royal Unit Trust may be important.**
Step 5 – Review whether the 15-year or retirement exemption applies and obtain the individual's total superannuation balance (if making NCCs)	In this case, the 15-year exemption applies, and the stakeholders will not be making any additional superannuation contributions (e.g., using the non-concessional contributions cap). If the stakeholders wish to make a CGT cap contribution to super, the Royal Unit Trust will need to: • Pay the exempt amount to CGT concession stakeholders within two years (based on their participation percentage). • Ensure the CGT cap contribution satisfies the requirements in S.292-100 (e.g., a written CGT cap election is provided to the fund).
Step 6 – Determine the level of superannuation contributions	From Step 5, work out the level of superannuation contributions and type that the taxpayer and/or the individual/s are planning to make. Then, ensure that the Royal Unit Trust makes the required payments, the super fund receives the contributions, and any required CGT cap elections, within the applicable time limits.

The Small Business CGT Concessions – The practical aspects

Case study 1 – Contributing the exempt amount to superannuation

- In relation to the 15-year exemption, the amount that can be contributed to superannuation is capped to the exempt amount paid out of the Royal Unit Trust within two years of the CGT event.
- In turn, being a unit trust, the CGT exempt amount is capped to the actual small business participation percentage of the stakeholder just before the CGT event (i.e., 25%)
- Therefore, the exempt payment to Charles and Camilla respectively is $487,500 (i.e., 25% x $1.95 million capital gain).

> **INFO**– Camilla and Charles could potentially increase their CGT cap amount up to their proportion of the **proceeds** – $525,000 (i.e., 25% x $2.1 million). However, tax consequences could arise on payment of the additional $37,500 from the unit trust (i.e., $525,000 – $487,500).

The Small Business CGT Concessions – The practical aspects

Case study 1 – Question: how can we influence the super contribution?

- As stated above, for the 15-year exemption, the amount that can be contributed to superannuation is based on the amount of the exempt payment
- For the Royal Unit Trust, assuming this is fixed, this is based on the stakeholder's percentage just before the CGT event
- In the case of the Royal Unit Trust, this can be influenced by changing the discretionary trust distributions for the 2020 income year

WARNING–If the Royal Unit Trust was a discretionary trust – the exempt payment (and therefore the maximum superannuation contribution) would be based on the formula:

$$\frac{100}{\text{Number of CGT concession stakeholders just before the CGT event}}$$

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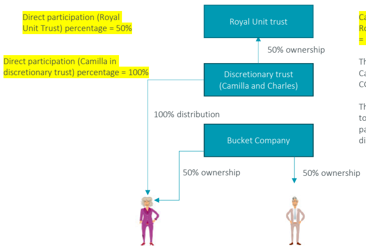
Case study 1 – Changing the exempt amount



Camilla's respective participation percentage in the Royal Unit Trust = 50% x 100% = 50%

Therefore, the exempt payment that could be made to Camilla (and potentially contributed to super under the CGT cap) is $975,000.

This has to be weighed up against the additional tax cost to Camilla of receiving the distribution (i.e., the tax payable by her on the distribution from the discretionary trust)

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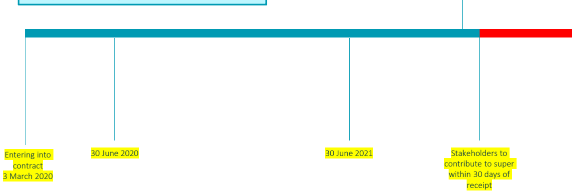
Case study 1 – 15-year exemption – time frames

WARNING–These time limits only apply where the 15-year exemption is made by a company or trust. Were the Royal Unit Trust a sole trader, the CGT cap contribution would need to be made by the due date lodgement of their personal 2020 return.



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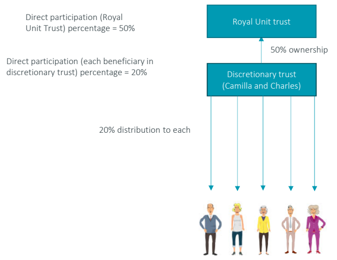
Case study 1 – How not to distribute in the 2020 income year



Each beneficiary's respective participation percentage in the Royal Unit Trust
= 20% x 100% = 10% (no significant individual for 2020 FY)

No significant individuals means:

- No exempt amount can be paid; and
- No CGT cap contributions can be made

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Case study 1 – Timing of the super contribution (15-year exemption)

- The amount must be paid out by Royal Unit Trust to Charles and Camilla by 2 March 2022 (i.e., within 2 years of the CGT event) to be tax-free
- Charles and Camilla must each contribute the payment to their fund within 30 days of receiving the exempt amount
- In relation to Kate and Will:
  - Assume their structure mirrors that of Charles and Camilla – meaning that they are both CGT concession stakeholders with a small business participation percentage of 25% each.
  - They can therefore benefit from the tax-free payment from the Royal Unit Trust.

TIP–Although under 55, Kate and Will are not required to contribute the exempt amount to super.

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Case study 1 – Summary of planning points (super)

- ✓ For the Royal Unit Trust, only one stakeholder needs to be aged at least 55 and meet the 'in connection with retirement' requirement
- ✓ Multiple contributions are permitted
- ✓ Strict two-year limit on payments received from the Royal Unit Trust (note exceptions for earnouts)
- ✓ Importance of the CGT concession stakeholder 'just before the CGT event' – this sets up the exempt payment amount (and therefore the contribution that can be made into super)

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Case study 2 – Retirement exemption

- Assume the same facts as above
- Based on the reasoning for Case Study 1, Charles and Camilla are CGT concession stakeholders of the Royal Unit Trust
- Assume that the structure is identical for Kate and William, and therefore they qualify to be CGT concession stakeholders of the Royal Unit Trust
- However, Kate and William do not wish to contribute any money into super

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Case study 2 – Retirement exemption

- The net capital gain made by the Royal Unit Trust before applying the CGT concessions is:

$1,950,000 x 50% CGT discount = $975,000

- The Royal Unit Trust would choose not to apply the 50% active asset reduction to increase the retirement exemption amount and reduce problems accessing the exempt amount
- The trust can allocate up to $975,000 between Charles and Camilla (%ages to add up to 100%) or choose a gain of less than $975,000 and distribute the balance to tax-effective beneficiaries (being careful to maintain CGT concession stakeholders)
- A written record should be made by the unit trust allocating the exempt amount (in this case – $975,000) between Charles and Camilla

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Case study 2 – Retirement exemption – time frames

- Should Camilla and Charles wish to contribute to superannuation, the following time frames would need to be adhered to:
  - The Royal Unit Trust needs to make the payment out to the CGT concession stakeholders by seven days after the company or trust makes the choice (generally, the actual date of lodgement of return)
  - Charles and Camilla then have 30 days from when they receive the payment from the Royal Unit Trust to contribute it to super under the CGT cap.

TIP–A written CGT cap election must be given to the fund trustee on or before the CGT cap contribution is made.

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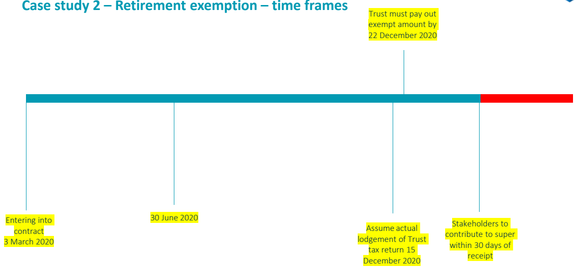
Case study 2 – Retirement exemption – time frames



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Planning points – retirement exemption

- ✓ Is an individual under 55? This assessment is made when the choice is made (generally, the actual date of lodgement)
- ✓ Individuals aged 55 and over are not compelled to contribute the exempt amount to super
- ✓ Consider the small business rollover to defer the gain for individuals close to age 55
- ✓ Unlike the 15-year exemption, CGT concession stakeholders are free to allocate the exempt amount in any proportion they so choose (to a lifetime maximum of $500,000 each)
- ✓ In contrast to the 15-year exemption, a significant individual is not required each year (only the year of sale)

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Common Q & A

Area	Question
Contributions	• What is the latest ATO view on contributing business real property in specie and treating it as a CGT cap contribution? • Can the CGT cap apply to the sale of a pre-CGT asset?
15-year exemption	• Do all stakeholders have to be aged 55 to benefit from the exemption?
Retirement exemption	• Can the retirement exemption be chosen by someone aged over 75?
Other	• Is the turnover requirement for a small business $2 million or $10 million?

The Small Business CGT Concessions – The practical aspects

Conclusion of presentation

- Questions?

SBCs and Super

Comprehensive Guide

Insyt has now released an in-depth guide on the interaction of the small business CGT concessions and superannuation:

Comprehensive Guide to the Small Business CGT Concessions and Super, by Darren Wynen (160 pages) – available now from:

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

https://www.cognitoforms.com/InsytPtyLtd/ComprehensiveGuideToTheSmallBusinessCGTConcessionsAndSuperannuation

SMSF Association 2020 National Conference attendees obtain a 20% discount for purchasing the guide before 15 March 2020.

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Contact details

Darren Wynen

Director, Insyt Pty Ltd

P: 03 9587 1029

M: 0450 325 286

E: darren@insyt.com.au

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