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CGT - 15-year-exemption

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Ruling

Print

Subject:CGT - 15-year-exemption

Question 1

Will the capital gain on the disposal of Farm land and the water rights attaching to the land qualify for access to the capital gains tax (CGT) Small Business Concessions pursuant to Subdivision 152-A of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Question 2

Are the requirements of the 15-year exemption, pursuant to subdivision 152-B of the ITAA 1997, met such that the entire capital gain arising on disposal of the Farm land and the water rights is wholly disregarded?

Answer

Yes.

This ruling applies for the following periods:

year ended 30 June 20xx

year ended 30 June 20xx

year ended 30 June 20xx

The scheme commenced on

1 July 20xx

Relevant facts and circumstances

1. Individual A died on xx xx xxxx.

2. Upon his death, Individual A owned the land known as xx, xx, xx, in xx in their personal capacity. The farm had been used in a primary production business for many years and a small amount of income arose from X rental properties located on the land.

3. Individual A had resided in the homestead on Lot xx as their main residence until their death.

4. At the time of Individual A's death, the farm relevantly included x lots of land.

5. Each lot was acquired by Individual A before the introduction of CGT in September 1985.

6. Pursuant to Individual A's Will the Lots were transferred to a testamentary trust, xx xx Trust (Trust), for the benefit equally of Individual A's x children, being the Primary Beneficiaries. They are:

- xx
- ...

7. All of the Primary Beneficiaries are currently over the age of 55. Noting that, XX's date of birth is xx xx xx and was xx years of age at 30 June 20xx.

8. Pursuant to Individual A's Will (clauses x, x and x), the farm, would be held in Trust and remain in the ownership of his descendants (being his above-named children in equal portions) for as long as his children wished to retain it, or until the date of the death of his last child. Until this time the Trustee was:

- required to manage and operate the farm
- able to use any income from the Trust, or any capital relating to a share portfolio which was also held in Trust as necessary for the upkeep and maintenance of the farm
- per the Trustee's absolute discretion, able to either:

a) accumulate the remaining income earned by the Trust so that it forms part of the capital of the Trust (which would on winding up of the Trust be distributed to the above beneficiaries); or

b) distribute the remaining income earned by the Trust in equal shares to the Primary Beneficiaries alive at the date on which the Trustees determined for each accounting year of the Trust that income is to be distributed.

In respect of b), if a Primary Beneficiary was not alive, further clauses would be invoked; all Primary Beneficiaries are currently alive, and no distributions of income have been made to any beneficiary other than the x children.

9. The Will also provides that on termination of the Trust, the Trust will vest, and the Trustees are to divide all remaining capital in equal shares to the Primary Beneficiaries who are alive at the Termination date (if no one Primary Beneficiary is alive at this time, further clauses would be invoked).

10. Since the Trust was established, Trust distributions of income (but not capital) have been made, as follows:

Table 1: Since the Trust was established, Trust distributions of income (but not capital) have been made, as follows:

Financial Year	xx	xx
20XX	x%	x%

11. On the basis that there is Trust income in the year ending 30 June 20xx, a distribution will be made equally to the x Beneficiaries.

12. The Trustees were and have always been Australian tax resident individuals; all X children were appointed accordingly as trustees.

13. A professional valuation of the x Lots of the farm was undertaken for probate purposes and was issued on xx June 20xx in the amount of $x.

14. Since 20xx, the Trust operated the primary production business and continued to receive rental income in respect of xx rental properties.

15. The Lots are adjoining and the primary production activity has been conducted on each of them.

16. The homestead on Lot XX (which was Individual A's main residence) had not been occupied as a main residence or for private purposes since Individual A's death. Use of the homestead had solely related to the management and running of the business by the Primary Beneficiaries.

17. Lot xx had been used, since XX 20xx, as follows:

- xx hectares of the total area had been in operating a primary production business, and
- xx hectares of the total area had been leased to unrelated parties.

This equates to 0.x% of the Lot area relating to rental and x.x% of the Lot area being used in conducting the Taxpayer's primary production business.

18. The area and usage of the lots is summarised in the following table:

Table 2: The area and usage of the lots is summarised in the following table:

Lot	Size (Ha)	Less rental (Ha)	Total Land for Cattle (Ha)	Cattle Usage (%)
Lot xx	x	x	x	x%
xx	x		x	100%
Total Size	**x**		**x**	

19. In determining income derived from the primary production business versus income derived from the rental property in respect of Lot XX, this is shown below:

Table 3: In determining income derived from the primary production business versus income derived from the rental property of Lot XX, this is shown below:

Financial Year	Primary Production Income	Percentage of Income %	Rental Income	Percentage of Income %
20x	$	%	$	%
"	"	"	"	"

20. The Trust entered into a contract to sell the farm, and the exchange of contracts occurred on xx xx xx.

21. The sale includes water rights which are attached to the land used for primary production.

22. The water rights were also acquired by Individual A pre-CGT and were transferred to the Trust pursuant to Individual A's Will in XX XX and have been used in conducting its primary production business from the farm until the date of settlement.

23. Total proceeds per the sale contract amounted to c$xx million and on entering into the contract, the purchaser paid a 10% deposit of $xx million.

24. When the purchaser was unable to meet the requirements of the sale contract, the deposit was forfeited, and the Trust subsequently distributed $xx million of the deposit to each of the x beneficiaries; this occurred before the end of the 20xx financial year.

25. On settlement, the purchaser was also required to pay additional late settlement fees amounting to $xx.

26. The sale results in a capital gain.

27. As a result of the farm and the primary production business being sold, pursuant to the Will and terms of the Trust, the Trust will vest and the Trustees will divide all remaining capital (and income) in equal shares between the Primary Beneficiaries who are alive at the Termination date. All Primary Beneficiaries will receive an equal amount of the capital (and income) on vesting.

28. Consequently, whilst the Trustee can accumulate income so that it forms part of the capital of the Trust, the Primary Beneficiaries will ultimately receive that capital on vesting of the Trust.

29. When the Primary Beneficiaries decided to continue to run the cattle business following the death of Individual A, it was agreed that they would have quarterly meetings to ensure proper oversight and communication to all Primary Beneficiaries as to the running of the cattle business.

30. There have also been many and varied communications between all Primary Beneficiaries outside of official quarterly meetings, especially as to purchases outside of the usual seasonal/calendar remit of expenses (outside budget etc.) and to usage of the property.

31. It was agreed that Individual B would be the main party engaged in running the farm and that the Manager would continue to be the full-time manager undertaking the day-today farming activities.

32. In providing an approximate summary of the hours per month spent by each of the Primary Beneficiaries on managing and running the primary production business operations (noting that farming operations fluctuate through seasons) and rental activities, the following is estimated:

- xx: 2-4 hours per month
- xx: 2-4 hours per month
- Individual B: xx-xx hours per month (x-x hours per week)
- Following the sale, the above hours have been reduced to nil.

33. The total income derived by the Trust for the financial year ended 30 June 20xx, was less than $2 million.

34. The Trust does not have any connected entities or affiliates; as detailed above, no one beneficiary has received distributions of 40% or more in the last 4 years and the influence of the Trustee Test is not met.

35. The Primary Beneficiaries are retired and the sale of the farm is in relation to their retirement and the resulting funds will be used to fund their retirement.

36. They will not be engaged in any other business following the disposal of the land and related water rights, and nor will they be deriving employment income.

37. All income is derived on arm's length terms.

38. The $6 million net asset value test will not be met.

39. None of the Primary Beneficiaries have used any of their $500,000 lifetime retirement exemption.

Relevant legislative provisions

Income Tax Assessment Act 1997 section 6-5

Income Tax Assessment Act 1997 subsection 104-10(2)

Income Tax Assessment Act 1997 subsection 104-10(4)

Income Tax Assessment Act 1997 subsection 104-10(3)

Income Tax Assessment Act 1997 section 108-5

Income Tax Assessment Act 1997 Division 128

Income Tax Assessment Act 1997 subsection 128-15(2)

Income Tax Assessment Act 1997 subsection 128-15(3)

Income Tax Assessment Act 1997 Division 152

Income Tax Assessment Act 1997 Subdivision 152-A

Income Tax Assessment Act 1997 Subdivision 152-B

Income Tax Assessment Act 1997 section 152-1

Income Tax Assessment Act 1997 subsection 152-10(1)

Income Tax Assessment Act 1997 subsection 152-10(1AA)

Income Tax Assessment Act 1997 subsection 152-10(2)

Income Tax Assessment Act 1997 section 152-35

Income Tax Assessment Act 1997 subsection 152-35(2)

Income Tax Assessment Act 1997 subsection 152-40(1)

Income Tax Assessment Act 1997 subsection 152-40(4)

Income Tax Assessment Act 1997 paragraph 152-40(4)(e)

Income Tax Assessment Act 1997 subsection 152-40(4A)

Income Tax Assessment Act 1997 section 152-50

Income Tax Assessment Act 1997 section 152-55

Income Tax Assessment Act 1997 section 152-65

Income Tax Assessment Act 1997 section 152-70

Income Tax Assessment Act 1997 subsection 152-70(1)

Income Tax Assessment Act 1997 section 152-100

Income Tax Assessment Act 1997 paragraph 152-105(d)(i)

Income Tax Assessment Act 1997 paragraph 152-110(1)(c)

Income Tax Assessment Act 1997 paragraph 152-110(1)(d)

Income Tax Assessment Act 1997 subparagraph 152-110(1)(d)(i)

Income Tax Assessment Act 1997 section 328-110

Income Tax Assessment Act 1997 subsection 328-110(1)

Income Tax Assessment Act 1997 section 328-115

*Income Tax Assessment Act 1997*section 328-120

Income Tax Assessment Act 1997 section 328-125

Income Tax Assessment Act 1997 section 328-130

Income Tax Assessment Act 1997 subsection 328-155(3)

Income Tax Assessment Act 1997 section 995-1

Reasons for decision

Basic conditions to access the Small Business CGT concessions

As stated in section 152-1 of the ITAA 1997, subdivision 152-A of the ITAA 1997 sets out the 'basic conditions' which must be satisfied in order for small business entities to qualify for any of the CGT small business concessions to reduce their capital gain by the various concessions in Division 152 of the ITAA 1997.

Basic conditions for small business concessions

Subsection 152-10(1) of the ITAA 1997 sets out the basic conditions which must be satisfied for a capital gain to be reduced or disregarded under this Division, as follows:

A capital gain (except a capital gain from CGT event K7) you make may be reduced or disregarded under this Division if the following basic conditions are satisfied for the gain:

(a) a CGT event happened in relation to a CGT asset of yours in an income year;

(b) the event would (apart from this Division) have resulted in the gain;

(c) at least one of the following applies:

(i) you are a CGT small business entity for the income year;

(ii) you satisfy the maximum net asset value test (see section 152-15);

(iii) you are a partner in a partnership that is a small business entity for the income year and the CGT asset is an asset of the partnership;

(iv) the conditions mentioned in subsection (1A) or (1B) are satisfied in relation to the CGT asset in the income year;

(d) the CGT asset satisfies the active asset test in section 152-35.

CGT event giving rise to a capital gain

A CGT asset is defined in section 108-5 of the ITAA 1997 to mean:

a. any kind of property;

b. a legal or equitable right that is not property.

Relevantly, under subsection 104-10(1) of the ITAA 1997, CGT event A1 happens if you dispose of a CGT asset.

Subsection 104-10(4) of the ITAA 1997 specifies the effect of CGT event A1 happening is that you make a capital gain if the capital proceeds from the disposal are more than the asset's cost base, or a capital loss if those capital proceeds are less than the asset's reduced cost base.

As per subsection 104-10(3) of the ITAA 1997, the time of the event is when you enter into the contract for the disposal, or, if there is no contract, when the change occurs.

The farm land and water rights are CGT assets of the Trust and when the contract for sale was executed on 2 June 2023 CGT event A1 in section 104-10 of the ITAA 1997 happened and resulted in a capital gain.

CGT small business entity

As defined in section 995-1 of the ITAA 1997, a CGT small business entity has the meaning given by subsection 152-10(1AA), as follows:

You are a **CGT small business entity** for an income year if:

(a) you are a small business entity for the income year; and

(b) you would be a small business entity for the income year if each reference in section 328-110 to $10 million were a reference to $2 million.

Subsection 328-110(1) of the ITAA 1997 defines small business entity as:

You are a **small business entity** for an income year (the **current year**) if:

(a) you carry on a business in the current year; and

(b) one or both of the following applies:

(i) you carried on a business in the income year (the **previous year**) before the current year and your aggregated turnover for the previous year was less than $10 million;

(ii) your aggregated turnover for the current year is likely to be less than $10 million.

Carrying on a business

As defined in section 995-1 of the ITAA 1997, a 'business' includes any profession, trade, employment, vocation or calling, but does not include occupation as an employee. *Taxation Ruling TR 97/11 Income Tax: am I carrying on a business of primary production?* (TR 97/11) provides the Commissioners view of the factors used to determine if a taxpayer is in business for tax purposes. Its principles are not restricted to questions of whether a primary production business is being carried on.

In this case it is stated that a business activity was being carried on by the Trust in the income year the CGT event happened.

Annual turnover

Section 328-120 of the ITAA 1997 sets out the meaning of 'annual turnover' as follows:

An entity's annual turnover for an income year is the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business.

The 'annual turnover' of an entity is defined in section 328-120 of the ITAA 1997 and is, 'the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business', excluding certain amounts relating to GST, derived from sales of retail fuel and derived from dealings with associates.

In general, income is derived in the ordinary course of carrying on a business if the income is of a kind that is regularly or customarily derived by the entity in the course of carrying on its business, arising out of no special circumstance or unusual event. Similarly, the income is derived in the ordinary course of carrying on a business if the income, although not regularly derived, is a direct result of the normal activities of the business.

Ordinary income may be derived in the ordinary course of carrying on a business even if it is not the main type of ordinary income derived by the entity. Similarly, the income does not need to account for a significant part of the entity's overall receipts. It is sufficient that the ordinary income is of a kind derived regularly or customarily in the carrying on of a business. However, income from a transaction that is unusual or extraordinary would not be included.

You state that the total income derived by the Trust for the financial year ended 30 June 20xx, was less than $2 million.

Aggregate Turnover

Section 328-115 of the ITAA 1997 provides the meaning of aggregated turnover for an income year (which is the sum of the relevant annual turnovers) and includes:

(a) your annual turnover for the income year; and

(b) the annual turnover for the income year of any entity (a relevant entity) that is connected with you at any time during the income year; and

(c) the annual turnover for the income year of any entity (a relevant entity) that is an affiliate of yours at any time during the income year.

Pursuant to section 328-125 of the ITAA 1997 an entity is connected with another entity if either entity controls the other entity or both entities are controlled by the same third entity.

Section 328-130 of the ITAA 1997 provides that an individual or a company is an affiliate if the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, in relation to the affairs of the business of the individual or company but is not an affiliate merely because of the nature of the business relationship between the you and the individual or company.

That there are no entities connected with or affiliates of the Trust such that their annual turnover is included in the aggregate turnover of the trust for the previous income year. Therefore, the aggregate turnover of the Trust is less than $2 million and the Trust is a 'CGT small business entity' for the income year as defined in subsection152-10(1AA) of the ITAA 1997.

Conclusion

In this case, it is stated that a business activity was being carried on by the Trust in the income year the CGT event happened. As there are no entities connected with or affiliates of the Trust such that their annual turnover is included in the aggregate turnover of the trust of for the previous income year and the trusts annual turnover for the previous income year is less than $2 million the Trust is a 'small business entity' within the meaning set out in subsection 152-10(1AA) of the ITAA 1997.

Active asset test

Section 152-35 of the ITAA 1997 outlines the 'active assets test', as follows in subsection 152-35(1) of the ITAA 1997:

A CGT asset satisfies the **active asset test** if:

(a) you have owned the asset for 15 years or less and the asset was an active asset of yours for a total of at least half of the period specified in subsection (2); or

(b) you have owned the asset for more than 15 years and the asset was an active asset of yours for a total of at least 7.5 years during the period specified in subsection (2).

Further, subsection 152-35(2) of the ITAA 1997 outlines that 'the period':

(a) begins when you acquired the asset; and

(b) ends at the earlier of:

(i) the CGT event; and

(ii) if the relevant business ceased to be carried on in the 12 months before that time or any longer period that the Commissioner allows - the cessation of the business.

Subsection 128-15(2) of the ITAA 1997 provides that the legal personal representative, or beneficiary, is taken to have *acquired the asset on the day you died. The Commissioner has a long-standing administrative practice of treating the trustee of a testamentary trust in the same way as a legal personal representative for the purposes of Division 128 of the ITAA 1997, in particular subsection 128-15(3) (PS LA 2003/12 *Capital gains tax treatment of the trustee of a testamentary trust*).

The farm land and water rights had been used in the primary production business since the assets devolved to the Trust under the terms of the will. The Trust's ownership of the CGT assets commenced on xx xx xx.

Section 152-40 of the ITAA 1997 outlines the meaning of 'active asset' at subsection 152-40(1) of the ITAA 1997 as follows:

A CGT asset is an **active asset** at a time if, at that time:

(a) you own the asset (whether the asset is tangible or intangible) and it is used, or held ready for use, in the course of carrying on a business that is carried on (whether alone or in partnership) by:

(i) you; or

(ii) your affiliate; or

(iii) another entity that is connected with you; or

(b) if the asset is an intangible asset - you own it and it is inherently connected with a business that is carried on (whether alone or in partnership) by you, your affiliate, or another entity that is connected with you.

Mixed use of a property

Subsection 152-40(4) of the ITAA 1997 lists CGT assets that cannot be active assets. Relevantly, under paragraph 152-40(4)(e) of the ITAA 1997, an asset whose main use is to derive rent cannot be an active asset unless the main use for deriving rent was only temporary.

The main use of CGT assets and the associated water rights have been used by the Trust solely in the primary production business and meet the requirement of the active asset test. However, an area in CGT an asset, Lot xx had been used for rental purposes. If the main use of the Lot was to derive rent at any time, the asset was not an active asset at that time.

When determining the main use of a CGT asset, as stated in subsection 152-40(4A) of the ITAA 1997, for the purposes of paragraph 152-40(4)(e) of the ITAA 1997:

(a) disregard any personal use or enjoyment of the asset by you; and

(b) treat any use by your affiliate, or an entity that is connected with you, as your use.

As the Lot was used partly to derive business income by the Trust and partly to derive rental income from unconnected third parties, it will be a question of fact depending on all the circumstances as to whether the main use of the asset, during some or all of the ownership period was to derive rent.

Taxation Determination TD 2006/78 - *Income Tax: capital gains: are there any circumstances in which the premises used in a business of providing accommodation for reward may satisfy the active asset test in section 152-35 of the Income Tax Assessment Act 1997 notwithstanding the exclusion in paragraph 152-40(4)(e) of the Income Tax Assessment Act 1997 for assets whose main use is to derive rent?* (TD 2006/78) considers the active asset test and the main use to derive rent concept.

Paragraph 26 of TD 2006/78 states:

If an asset is used partly for business and partly to derive rent at any given time, it will be a question of fact depended on all the circumstances as to whether the main use of the asset at the time is to derive rent. No one single factor will necessarily be determinative, and resolving the matter is likely to involve a consideration of a range of factors such as:

- the comparative areas of use of the premises (between deriving rent and other uses); and
- the comparative levels of income derived from the different uses of the asset.

Example 5 in TD 2006/78 considers the mixed use of a property and states:

Mick owns land on which there are a number of industrial sheds. He uses one shed (45% of the land by area) to conduct a motorcycle repair business. He leases the other sheds (55% of the land by area) to unrelated third parties. The income derived from the motorcycle repair business is 80% of the total income (business plus rentals) derived from the use of the land and buildings.

In determining if the main use of the land is to derive rent, it is appropriate to consider a range of factors. In this case, a substantial (although nevertheless not a majority) proportion by area of the land is used for business purposes. As well, the business proportion of the land derives the vast majority (80%) of the total income. In all the circumstances, the Tax Office considers the main use of land in this case is not to derive rent and accordingly the land is not excluded from being an active asset by paragraph 152-40(4)(e).

No one single factor will necessarily be determinative, resolving the matter involves a consideration of:

- the comparative areas of use of the Lot (between deriving rent and business uses), and
- the comparative levels of income derived from the different uses of the Lot.

In this case the area of the Lot which has been used, since the transfer to Trust, for rental purposes is approximately 0.x% and the area relating conducting the Trust's primary production business is x%. Given the comparative areas of use of the Lot, the main use is that of being used in the business. From the figures provided, it is evident that the main use of the Lot during the relevant financial years, being a period of 15 years, was mainly to derive revenue for the primary production business.

Consequently, each of the Lots, are an active asset which had been owned by the Trust for more than 15 years and the assets had been active for more than 7.5 years.

The water rights were acquired in by the transfer pursuant to Individual A's will and had since been used in conducting its primary production business from the Lots until the date of settlement.

Consequently, the water rights, are active assets which had been owned by the Trust for more than 15 years and the asset had been active for more than 7.5 years.

Conclusion

In this case a CGT event happened in relation to a CGT asset of the Trust, the farm land and water rights, which resulted in a capital gain; the Trust was a CGT small business entity for the income year as its aggregate turnover for the income year prior to the income year ending 30 June 20xx was less than $2 million and the farm land and water rights satisfy the active asset test in section 152-35 of the ITAA 1997 as they were CGT assets used in the business conducted by the Trust. Consequently, as all 4 basic conditions are met, the basic conditions to access the Small Business CGT concessions apply to the sale of the farm land and the water rights.

Question 2

Summary

As set out above, the Trust satisfies the basic conditions in Subdivision 152-A of the ITAA 1997 and the CGT assets were continuously owned by the same party for more than 15 years before the CGT event. During the period of ownership of the CGT assets, the Trust had a significant individual for a total of at least 15 years who was over the age of 55 years old at the time of the CGT event. The significant individual has retired and the capital proceeds from the sale of the CGT assets will be used to fund the retirement of the significant individual. Therefore, the Trust can disregard the capital gain made on the disposal of the CGT assets.

Small Business 15-year Exemption (section 152-110)

Section 152-100 of the ITAA 1997, subdivision 152-B of the ITAA 1997 sets out that a CGT small business entity can disregard a capital gain arising from a CGT asset that it has owned for at least 15 years if certain conditions are met.

Relevantly, section 152-110 of the ITAA 1997 outlines the 15-year exemption for companies and trusts as follows:

152-110 (1) An entity that is a company or trust can disregard any capital gain arising from a CGT event if all of the following conditions are satisfied:

(a) the basic conditions in Subdivision 152-A are satisfied for the gain;

(b) the entity continuously owned the CGT asset for the 15-year period ending just before the CGT event;

Note: Section 152-115 allows for continuation of the period if there is an involuntary disposal of the asset.

(c) the entity had a significant individual for a total of at least 15 years (even if the 15 years was not continuous and it was not always the same significant individual) during which the entity owned the CGT asset;

(d) an individual who was a significant individual of the company or trust just before the CGT event either:

(i) was 55 or over at that time and the event happened in connection with the individual's retirement; or

(ii) was permanently incapacitated at that time.

152-110 (2) Any ordinary income or statutory income the company or trust derives from a CGT event that would be covered by subsection (1) (assuming the event gave rise to a capital gain, even if it didn't) is neither assessable income nor exempt income.

Significant individual

Section 152-50 of the ITAA 1997 provides that an entity satisfies the significant individual test if the entity had at least one significant individual just before the CGT event.

Under section 152-55 of the ITAA 1977 an individual is a significant individual in a company or trust if they have a small business participation percentage in the company or trust of at least 20%.

Section 152-65 of the ITAA 1997 provides that an entity's small business participation percentage in another entity at a time is the percentage that is the sum of:

a) the entity's *direct small business participation percentage in the other entity at that time; and

b) the entity's *indirect small business participation percentage in the other entity at that time.

Section 152-70 of the ITAA 1997 provides that an entity holds a direct small business participation percentage at the relevant time in an entity equal to the percentage worked out using this table:

Table 4: Section 152-70 of the ITAA 1997 provides that an entity holds a direct small business participation percentage at the relevant time in an entity equal to the percentage worked out using this table.

In this entity:	Is:	
1	...	
2	A trust (where entities have entitlements to all the income and capital of the trust)	This percentage: (a) the percentage of any distribution of income that the trustee may make to which the entity would be beneficially entitled; or (b) the percentage

		of any distribution of capital that the trustee may make to which the entity would be beneficially entitled; or, if they are different, the smaller.
3	A trust (where entities do not have entitlements to all the income and capital of the trust)	This percentage: (a) if the trustee makes distributions of income during the income year (the ***relevant year***) in which that time occurs - the percentage of the distributions to which the entity was beneficially entitled; or (b) if the trustee makes distributions of capital during the relevant year - the percentage of the distributions to which the entity was beneficially entitled; or, if 2 different percentages are applicable, the smaller

For the purposes of section 152-75 of the ITAA 1997, an entity's indirect small business participation percentage in a trust is calculated by multiplying together the entity's direct participation percentage in an interposed entity, and the interposed entity's total participation percentage (both direct and indirect) in the trust.

ATO Interpretative Decision ATO ID 2015/8 *Income tax: CGT small business concessions: small business participation percentage - trust where entities have entitlement to all income and capital of the trust* explains the Commissioner's approach to determining entitlement to trust income and capital for the purposes of determining an individual's small business participation percentage (as set out below).

Although 'income' is not relevantly defined, in context, it has the meaning which it has for the purposes of the general law of trusts (see e.g. ATO Interpretative Decision ATO ID 2012/99 *Income Tax Capital gains tax - direct small business participation percentage in a trust - meaning of 'distributions of income' and capital*). Similarly, it is considered that 'capital' has the meaning which it has for the purposes of the general law of trusts.

Accordingly, a determination of whether a trust is an entity to which item 2 or item 3 of the table in subsection 152-70(1) of the ITAA 1997 applies, depends on whether or not, on a proper construction of the trust instrument, there is any amount of income or capital of the trust to which no beneficiary is entitled at the relevant time.

The 'relevant time' (as that phrase is used in subsection 152-70(1) of the ITAA 1997) for making the determination is, with respect to the additional basic conditions, 'just before the CGT event' (subsection 152-10(2) of the ITAA 1997).

Accordingly, a trust instrument which gives the trustee discretion to appoint or distribute income or capital to one or more of a class of beneficiaries is a trust where entities do not have entitlements to all the income and capital of the trust. Although entities may become entitled to the income and capital of the trust as a result of the exercise of the trustee's discretion, those entitlements do not exist before that time.

Whilst every case will turn on a proper construction of the trust instrument, the power in the trustee to accumulate income of the trust may not of itself cause the trust to be one in which beneficiaries do not have entitlements to all the income and capital of the trust. Generally, an accumulation clause gives the trustee a power to effectively cause part of the income of the trust estate to be capital of the trust estate.

Provided that, under the trust instrument, one or more beneficiaries has, at the relevant time, an entitlement to all of the income and capital of the trust, including any accumulated income or capital, the trust will be a trust to which item 2 of the table in subsection 152-70(1) of the ITAA 1997 applies. For the purposes of determining whether or not a trust is a trust to which item 2 or item 3 of the table in subsection 152-70(1) applies, it does not matter whether the same beneficiary or beneficiaries have an entitlement to the accumulated income or capital.

In this case the Commissioner considers that pursuant to the operation of Clause x, Clause x and Clause x, of the Will the beneficiaries have fixed entitlements to the income and capital of the testamentary trust and there are no clauses in the Will that authorise the trustee to do anything that would cause their entitlement to be defeased.

In this case, in accordance with the terms of the Will, the Primary Beneficiaries each have a beneficial entitlement to any income or capital distributions the trustee may make of more than 20% for the period from xx xx xx to xx xx xx. All Primary Beneficiary individuals have small business participation percentage of more than 20%. Consequently, all Primary Beneficiary individuals are significant individuals of the Trust for more than 15 years satisfying paragraph 152-110(1)(c) of the ITAA 1997.

Was 55 or over at that time

Paragraph 512-110(1)(d) of the ITAA 1997 requires that just before the CGT event the Trust has at least one significant individual that was 55 years of age or over. In this case x of the Primary beneficiaries are significant individuals and were over the age of 55 at the time of the CGT event.

In Connection with retirement

The Explanatory Memorandum (EM) to the New Business Tax System (Capital Gains Tax) Bill 1999 makes the following comments about the requirement to be permanently incapacitated or retiring as one of the conditions for the concession:

'1.68 One of the requirements of this concession for an individual small business taxpayer is that they must be either permanently incapacitated at the time of the CGT event, or at least 55 years old and using the capital proceeds for their retirement.'

This wording would suggest that the funds arising from the disposal of the asset must predominantly be intended to fund the retirement of the individual (whether or not supplemented by other monies).

It would similarly follow that where the funds are intended to be employed in a manner other than funding the individual's retirement (for example the acquisition of a new business that the individual will have an active role in, or the gifting of the monies, or the investment of the monies within the trust for the benefit of family members generally at the Trustee's discretion) then the test will not be satisfied.

The phrase 'in connection with' has been judicially considered in numerous cases.

In *Collector of Customs v Pozzolanic Enterprises Pty Ltd* (1993) 43 FCR 280 (*Pozzolanic*), it was stated by the Full Court of the Federal Court that:

The words 'connected with' are capable of describing a spectrum of relationships ranging from the direct and immediate to the tenuous and remote. As Sheppard and Burchett JJ observed in *Australian National Railways Commission v Collector of Customs (SA)* [(1985) 69 ALR 367 at 377-378; 8 FCR 264, at 265] the meaning of the word 'connection' is wide and imprecise, one of its common meanings being 'relation between things one of which is bound up with, or involved in, another': *Shorter Oxford English Dictionary*. (at 288)

Given the potential width of the words 'in connection with', the question remains in a particular case what kind of relationship will suffice to establish the connection contemplated by the statute. This in turn will require a value judgment about the range of the statute: see e.g. Pozzolanic at 289 and *Taciak v Commissioner of Australian Federal Police* (1995) 59 FCR 285 at 295.

Wilcox J of the Federal Court considered the meaning of the phrase 'in connection with the retirement' in *Claremont Petroleum NL v Cummings* (1992) 110 ALR 239 (Claremont). The case concerned the application of provisions within the Queensland Companies Code and in particular, whether payments made were in connection with the retirement of certain individuals. Wilcox J made the following observations on the phrase 'in connection with:

The phrase "in connection with" is one of wide import, as I had occasion to observe in a different context in *Our Town FM Pty Ltd v Australian Broadcasting Tribunal* (1987) 16 FCR 465 at p479-80; 77 ALR 577 at pages 591-2:

The words 'in connexion with'...do not necessarily require a causal relationship between the two things: see *Commissioner for Superannuation v Miller* (1985)8 FCR 153 at 154, 160, 163; 63 ALR 237at 238, 244, 247. They may be used to describe a relationship with a contemplated future event: see *Koppen v Commissioner for Community Relations* (1986) 11 FCR 360 at 364, *Johnson v Johnson* [1952] P 47 at 50-1. In the latter case the United Kingdom Court of Appeal applied a decision of the British Columbia Court of Appeal, *Re Nanaimo Community Hotel Ltd* [1945] 3 DLR 225, in which the question was whether a particular court, which was given 'jurisdiction to hear and determine all questions that may arise in connection with any assessment made under this Act', had jurisdiction to deal with a matter which preceded the issue of an assessment. The trial judge held that it did, that the phrase 'in connection with' covered matters leading up to, or which might lead up to an assessment. He said...: 'One of the very generally accepted meanings of "connection" is "relation between things one of which is bound up with or involved in another"; or, again "having to do with". The words include matters occurring prior to as well as subsequent to or consequent upon so long as they are related to the principal thing. The phrase "having to do with" perhaps gives as good a suggestion of the meaning as could be had.'

Having regard to the context of subparagraph 152-110(1)(d)(i) of the ITAA 1997, the Commissioner considers that it would be reasonable to adopt the meaning given to the phrase 'in connection with' in Claremont such that it is not necessary for there to be a permanent and everlasting retirement from the workforce; however, there would need to be at least a significant reduction in the number of hours worked or a significant change in the nature of the activities to be regarded as a retirement for the purposes of paragraph 152-110(1)(d)(i) of the ITAA 1997.Whether a CGT event, happens in connection with an individual's retirement depends on the particular circumstances of each case.

Similarly, the words 'in connection with' can apply where the CGT event occurs sometime after retirement. Again, this would depend on the particular facts, and would need to be considered on a case-by-case basis.

In this case, a significant individual has stated that they are retired and the sale of the farm is in relation to their retirement and the resulting funds will be used to fund their retirement. The significant individual will not be engaged in any other business following the disposal of the land and related water rights, and nor will they be deriving employment income. Consequently, the CGT event can reasonably be accepted as having the necessary connection with their retirement provided the funds are used for the benefit of their retirement.

The conditions for relief in Subdivision 152-B have been satisfied as the basic conditions in Subdivision 152-A are satisfied; the Trust had continuously owned the CGT asset for the 15-year period ending just before the CGT event; a significant individual was over the age of 55 at the time of the CGT event; and the event was in connection with their retirement.

As such, the Commissioner is satisfied that in these circumstances of the sale of the CGT assets by the Trust is in connection with the retirement of the relevant individual for the purposes of subparagraph 152-105(d)(i) of the ITAA 1997.