The Tax Institute

VIC Tax Forum

Small Business Restructures - Strategies, avoiding pitfalls and case studies

Presented at VIC Tax Forum 21-22 March 2024

Andrew Henshaw CTA
Velocity Legal

Contents

1. Definitions

All references in this paper to:

(a) **'ITAA36**' means the *Income Tax Assessment Act* 1936 (Cth);

(b) '**ITAA97**' means the *Income Tax Assessment Act* 1997 (Cth); and

(c) '**Explanatory Memorandum**' means the Explanatory Memorandum to the *Tax Laws Amendment (Small Business Restructure Roll-over) Bill 2016* (Cth).

Unless otherwise stated, all references to Divisions, Subdivisions and sections are references to Divisions, Subdivisions and sections contained in the ITAA97.

2. Overview

2.1 Small Businesses – A Unique Position

Small Businesses are in unique position in that they typically have more tools available to reduce, eliminate or rollover the tax liabilities that would otherwise arise from a business restructure. For that reason, the businesses restructuring landscape for small businesses is significantly different than for larger businesses. So much was noted by the Board of Taxation's Review of CGT Roll-Overs Consultation Paper.[1]

In addition to general CGT rollovers such as those contained in Subdivisions 122A, 122-B, 124-N, 124-M and Division 615, the restructure options available to small businesses include the Small Business Restructure Rollover (Subdivision 328-G) and the Small Business CGT Concessions (Division 152). A small business restructure may (at least in theory) also use a combination of these.

A restructure using the Small Business Restructure Rollover or the Small Business CGT Concessions (***if available***) is often preferred to a restructure using the general CGT rollovers. The reason for that preference will depend on the taxpayer's individual situation and exactly what is proposed.

This paper aims to provide an in-depth analysis of using the Small Business Restructure Rollover and the Small Business CGT Concessions to facilitate a business restructure. Specifically, the paper addresses the following:

- small business restructure rollover (Subdivision 328-G);
- the use of the small business CGT concessions to facilitate a restructure (Division 152);
- the opportunities and potential pitfalls in using either to facilitate a restructure;
- case studies; and
- reform.

Please note that an analysis of the general CGT rollovers is beyond the scope of the paper.

2.2 Why Restructure?

A business owner or their advisors may identify situations where a business or its assets are held in a less than optimal structure. A business owner may consider restructuring for any of the following reasons:

- estate and succession planning;
- to accommodate growth;
- merging or the introduction of new equity;
- opportunities to attract new investors;
- a desire to move from non-corporate entities to corporate entities;
- a desire to move from corporate entities to non-corporate entities;
- asset protection; or
- exit plans.

[1] Issued in December 2020 and available at the following link: https://taxboard.gov.au/consultation/review-of-cgt-roll-overs

There is not a 'one size fits all' approach to restructuring a business. There are a range of different rollovers available for business owners to consider and it is not always possible for taxpayers to use a CGT rollover that satisfies all tax and commercial objectives.

2.3 Comparison Table: SBRR and SBC

The table below sets out the key differences, at a glance, between the Small Business Restructure Rollover or the Small Business CGT Concessions.

	SBC	SBRR
Eligible entities	Individual, trust, partnership and company	Individual, trust, partnership and company
Eligible assets	Active assets; shares or units	Active assets; trading stock, depreciating assets and revenue assets
Aggregated turnover threshold	$2 million (or $6 million net assets)	$10 million
Value assets transferred at	No requirement for consideration	No requirement for consideration
Residency requirement	✗ (except if the CGT asset is a share or unit)	✓
Is a change in Ultimate Economic Ownership permitted?	✓	✗
Restriction on asset disposal?	✗	✓ (no safe harbour if disposal within 3 years)
Allows for superannuation contribution?	✓ (access to CGT cap)[2]	✗
Sale or succession planning	✓	✗ (difficulties satisfying the genuine restructure requirement)

[2] $1,705,000 for the 2023-2024 income year.

3. Small Business Restructure Rollover

3.1 Background

The Small Business Restructure Rollover (**SBRR**) was introduced with the intention of providing greater flexibility for 'small businesses' to change their legal structure. Despite that good intention, the take up and use of the SBRR generally remains limited (more on that in Part 5).

The SBRR came into effect on 1 July 2016 and the rules are set out in Subdivision 328-G. The stated purpose of the SBRR is to allow small businesses to restructure their business to suit their objectives, without triggering direct income tax consequences (such as capital gains tax or income tax liabilities).

Unlike general CGT rollovers (which typically involves restructuring into a company with strict ownership requirements), the SBRR is versatile and can allow for the transfer of assets between different types of entity structures, including:

- one company to another company;
- a company to a trust or an individual;
- a partnership to a company; or
- a trust to another trust.

The SBRR is not limited to CGT assets, and relief also applies to other forms of business assets (e.g. depreciating assets, trading stock and revenue assets).

3.2 Key Requirements

Subsection 328-430(1) of the ITAA97 sets out the key requirements that need to be satisfied to apply the SBRR. Those requirements are as follows:

(a) the transaction is, or is part of a 'genuine restructure' of an ongoing business; and
(b) each party to the transfer is an entity to which any one or more of the following applies:
  (i) it is a small business entity for the income year during which the transfer occurred;
  (ii) it has an affiliate that is a small business entity for that income year;
  (iii) it is connected with an entity that is a small business entity for that income year; or
  (iv) it is a partner in a partnership that is a small business entity for that income year; and
(c) the transaction does not have the effect of materially changing:
  (i) which individual has, or which individuals have, the ultimate economic ownership of the asset; and
  (ii) if there is more than one such individual – each such individual's share of that ultimate economic ownership; and
(d) the asset is a CGT asset (other than a depreciating asset) that is, at the time the transfer takes effect:
  *(i) if subparagraph (b)(i) applies--an * active asset; or*
  (ii) if subparagraph (b)(ii) or (iii) applies--an active asset in relation to which subsection 152-10(1A) is satisfied in that income year, or would be satisfied in that income year if paragraph 152-10(1AA)(b) were disregarded; or
  (iii) if subparagraph (b)(iv) applies--an active asset and an interest in an asset of the partnership referred to in that subparagraph; and

(e) *the transferor and each transferee meet the residency requirement in section 328-445 for an entity; and*
(f) *the transferor and each transferee choose to apply a roll-over under this Subdivision in relation to the assets transferred under the transaction.*

The SBRR is not available to tax-exempt entities and complying superannuation funds.

3.3 Examining the 'core concepts'

The requirements set out above identify a few 'core concepts'. These are:

- a **small business entity**;
- an **active asset**;
- a **genuine restructure**; and
- no change in **ultimate economic ownership**.

Each concept is discussed below.

3.3.1 Small business entity

A 'small business entity' is defined in subsection 328-110(1) as:

(1) *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.*

In determining the aggregated turnover of an entity, it is important to note that the turnover also includes entities that are either 'affiliates' of or 'connected with' the taxpayer. The definition in subsection 328-110(1) requires an understanding of the definitions of several terms (aggregated turnover, annual turnover, carrying on a business, affiliate and connected with – to name a few).

In determining whether a company is 'carrying on a business', reference should be had to Taxation Ruling TR 2019/1, where the Commissioner of Taxation acknowledges that where a company aims to make, and has a prospect of profit, it is presumed that the company carries on a business.[3]

In terms of the four core concepts, this is generally the simplest to apply.

3.3.2 Active Asset

The active asset requirements for the SBRR build on concepts within the small business CGT concessions. For a discussion regarding the scope of the term 'active asset', refer to Full Federal Courts comments in *Eichmann v FCT* [2020] FCAFC 155 - for an asset to qualify as an active asset, it

[3] Paragraph 19, TR 2019/1.

is sufficient if the asset is used at some point in the course of the carrying on of an identified business.[4]

Difficulties can arise in determining whether real property is an active asset, particularly where that real property has multiple uses (for example, a combination of private and business, or a combination of active business income and passive rental income).

There are two key differences between how the active asset requirements apply to the SBRR as compared with the small business CGT concessions:

- unlike the 'active asset test' under the small business CGT concessions (which is a period of time test), the asset merely needs to be an active asset at the time the transfer (a point in time test). Situations can arise where long held business real property has become an 'active asset' (**point in time**), but cannot yet satisfy the 'active asset test' (**period of time**) – and vice versa ; and

- where the parties to the transfer are not exclusively small business entities (and instead of affiliates or connected with a small business entity), subsection 152-10(1A) must be satisfied. One requirement of that subsection is that the small business entity must carry on the business 'in relation to the CGT asset'.[5]

3.3.3 Genuine Restructure

To qualify for the SBRR, a proposed restructure must be a 'genuine restructure of an ongoing business'. The term 'genuine restructure' is not defined in the ITAA97 and nor is it a term that has a body of case law behind it. For that reason, regard should be had to:

- the Explanatory Memorandum;
- arguably with caution, the ATO's views (most notably Law Companion Guide LCG 2016/3); and
- the safe harbour mechanism.

3.3.3.1 Explanatory Memorandum

The Explanatory Memorandum provides that:

- the genuine restructure principle distinguishes genuine restructures from artificial or inappropriately tax-driven schemes.
- whether a restructure is 'genuine' is a question of fact that is determined having regard to all of the facts and circumstances surrounding the restructure.
- some of the factors indicating a genuine restructure include:
  - it is a bona fide commercial agreement undertaken to enhance business efficiency;
  - the business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership;
  - the transferred assets continue to be used in the business;
  - the restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business;

---

[4] Paragraph 41, Eichmann v Commissioner of Taxation [2020] FCAFC 155.
[5] This generally precludes the transfer of shares qualifying for the SBRR. This issue is discussed in greater detail below.

- the restructure is not artificial or unduly tax driven; and
- it is not a divestment or preliminary step to facilitate the economic realisation of assets.

Note that it is well accepted that the words of an Explanatory Memorandum cannot be determinative of the legal meaning of a phrase (or in the present case, which factors are relevant).

3.3.3.2 LCG 2016/3

Law Companion Guideline LCG 2016/3 provides further guidance on various aspects of the SBRR. LCG 2016/3 discusses the Commissioners views on what is considered a genuine restructure. LCG 2016/3 notes at paragraph 6 that a 'genuine restructure of an ongoing business' is one that could be reasonably expected to deliver benefits to small business owners in respect of their efficient conduct of the business. It can encompass a restructure of the way in which business assets are held where that structure is likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business.

In the same paragraph 6, the Commissioner emphasis that the requirement is not whether the transaction is a ‘genuine restructure’, but rather whether the transaction is a ‘genuine restructure *of an ongoing business*’. For that reason, the Commissioner’s view is that the requirement it is a composite phrase emphasising that the SBRR is not available to small business owners who are restructuring in the course of winding down or realising their ownership interests. The Commissioner’s interpretation of LCG 2016/3 is interesting given that the Explanatory Memorandum contains very little discussion of the ‘ongoing business’ element (as compared to the ‘genuine restructure’ element). Furthermore, the ‘ongoing business’ element itself is also picked up in the active asset test.

3.3.3.3 Safe Harbour Rules

Given the complexity and uncertainty on whether a transaction is a ‘genuine restructure’, section 328-435 contains a safe harbour rule, which can be relied on as an alternative.

Under the safe harbour rule, a transaction will be a genuine restructure of an ongoing business if in the **three years** after the transaction takes effect:

- there is no change in the ultimate economic ownership of any of the significant assets of the business (other than trading stock) that were transferred under the transaction;
- those significant assets continue to be active assets; and
- there is no significant or material use of those significant assets for private purposes.

Failing the safe harbour rule does **not** limit the circumstances in which a transaction is, or is part of, a genuine restructure of an ongoing business. For example, in the case of a business that is restructured via the SBRR, and then sold two years later, the restructure can still qualify for the SBRR by satisfying the general principle that the transaction is, or is part of, a genuine restructure of an ongoing business.

3.3.4 Ultimate Economic Ownership

The ultimate economic ownership requirement is often referred to as that ***there cannot be a change in ultimate economic ownership***. This is shorthand reference and is not the test prescribed by the legislation. The rules forbid a change in the individual or individuals that have ultimate economic ownership (or if there is more than one individual who has ultimate economic ownership, their share of the ultimate economic ownership). The SBRR does not require that the ultimate economic ownership be ascertained on either side of a proposed transaction.

The term ‘ultimate economic ownership’ is not defined. The Explanatory Memorandum states that the ultimate economic owners of an asset *“are the individuals who, directly or indirectly, beneficially own an asset”*.[6] The Explanatory Memorandum further states that ultimate economic ownership of an asset can only be held by natural persons (and not companies, partnerships or trusts).

The concept of ‘ultimate economic ownership’ is clear enough for companies and unit trusts (other than those with hybrid elements), however the concept is at odds with the very notion of a discretionary trust.

Where a discretionary trust is concerned (or a non-fixed unit trust, such as a hybrid unit trust), it is generally not possible to determine proportionate ultimate economic ownership of the assets of the trust. This is because the trustee will generally have a broad discretion to appoint the income or capital of the trust to any of the beneficiaries of the trust, at their sole discretion.

As stated in *Private Binding Ruling 1052195043880 (issued 23 November* 2023):

> *Under ordinary legal concepts, a beneficiary of a discretionary trust is not entitled to income or capital of the trust until the trustee exercises their discretion to distribute income or to make an appointment of capital.* ***As such, beneficiaries of a discretionary trust cannot have ultimate economic ownership of the assets held by the trust.***

For that reason, the SBRR rules contain ultimate economic ownership deeming provisions in respect of certain non-fixed trusts. In particular, section 328-440 provides that:

> *For the purposes of paragraph 328-430(1)(c), a transaction does not have the effect of changing the ultimate economic ownership of an asset, or any individual’s share of that ultimate economic ownership, if:*

(a) either or both of the following applies:
- *(i) just before the transaction took effect, the asset was included in the property of a *non-fixed trust that was a *family trust;*
- *(ii) just after the transaction takes effect, the asset is included in the property of a non-fixed trust that is a family trust; and*

(b) every individual who, just before the transfer took effect, had the ultimate economic ownership of the asset was a member of the family group (within the meaning of Schedule 2F to the Income Tax Assessment Act 1936) relating to the trust or trusts referred to in paragraph (a); and

(c) every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that family group.

Based on the Explanatory Memorandum, the ‘ultimate economic ownership deeming provisions’ appear to have been intended to enable the transfer of assets from an individual to a discretionary trust. See Example 1.3:

> *Chris and Victoria are husband and wife and are the only shareholders in Puppy Co, with each owning one share with a cost base of $2 per share.*

[6] Ibid.

> *Puppy Co has successfully carried on a puppy training school and has acquired significant assets including puppy boarding facilities, a vehicle, and goodwill.*
>
> *Victoria and Chris wish to transfer the puppy boarding premises from Puppy Co to a recently settled discretionary trust, the Fluffy Trust, which will lease the premises to Puppy Co. The family trust election is made nominating Victoria as the primary individual controlling the trust. Victoria and Chris are members of Victoria's family group.*
>
> *For the purpose of the roll-over, there will not be a change in the ultimate economic ownership of the premises as a result of the transfer of the asset from Puppy Co to the Fluffy Trust. Therefore, assuming that the other requirements are also met, the roll-over would be available in respect of the transfer.*

More on the issues with the 'ultimate economic ownership' requirements below.

4. Opportunities within the SBRR

Firstly – the good. The SBRR is unique and provides for restructuring benefits and opportunities that do not exist with other alternatives (such as using the small business CGT concessions or a general CGT rollover). Below is a summary of some of the opportunities available under the SBRR.

4.1 Preserve Pre-CGT Status

Section 328-460 of the ITAA97 provides that where a pre-CGT asset is transferred under an SBRR, the transferee is taken to have acquired the asset before 20 September 1985. In other words, pre-CGT status will be preserved. This can have immense benefit particularly in relation to real property that is an active asset (e.g. business property owned by an individual that is transferred to a family trust).

Note: section 328-460 is worded to only apply to the asset being transferred. For example, if the transferee were a newly established company, the shares in that company themselves **cannot** be or become a pre-CGT asset. The same would apply to a unit trust.

4.2 Preserve Clock for 15-Year Exemption

The SBRR does not 'reset the clock' for the purposes of the 15-Year Exemption.[7] That is, the transferee is treated (for the purposes of the 15-year time requirement and the 15-year significant individual requirement) as having acquired the asset when the transferor acquired it.

It is noted that this ability is unique amongst restructures. The 'continuing time periods' for the 15-year exemption are otherwise limited to compulsory acquisitions, loss and destruction cases, FSR transitions and relationship breakdowns.

Note: subsection 152-115(3) is worded to only apply to the asset being transferred. For example, if the transferee were a newly established company, the shares in that company are **not** afforded the same benefit. This may lead to situations where a business sale qualifies for the 15-year exemption, however a share sale may not. The same would apply to a unit trust.

4.3 Vendor Finance Consideration – Non-Corporate to Corporate

Unlike the general CGT rollovers, the SBRR rules do not contain any requirements for consideration. It is therefore open for a transferor to transfer assets to a transferee at:

- no or nominal value;
- market value;
- some other figure.

Where an SBRR involves a non-company transferor (e.g. discretionary trust) and a company transferor, it appears open for the taxpayers involved to decide that the restructure will occur for a full market value purchase price, with that price to be paid on vendor finance terms. Alternatively, it may

[7] Subsection 152-115(3) of the ITAA97.

that unpaid present entitlements exist between a discretionary trust and a company that can be satisfied as a result of the restructure.

The benefit of this is essentially that the transferor company can derive income from the restructured asset, pay corporate tax, and then repay the vendor finance amount. This leads to the unusual situation where the transferee does not have a capital gain (owing to the SBRR), but is entitled to the benefit of a loan receivable (which in the author's view, does not attract Division 7A). This is one reason why a client may opt to restructure into a company using the SBRR, rather than Subdivision 122-A.[8]

4.4 No Consideration – Corporate to Non-Corporate

Section 328-450 provides that where the SBRR applies, a transfer of an asset has no 'direct consequences' under the income tax law. Bearing in mind that SBRR has no requirements regarding consideration, the note to subsection 328-450(1) refers to the Division 7A consequences of a transaction being ignored. The example states:

> *Example: If the transfer were a transfer of the asset from a company to a shareholder, it would not be treated as a payment of a dividend under Division 7A of Part III of the Income Tax Assessment Act 1936.*

Under the SBRR, a company could transfer its active business assets to a shareholder or an associate of a shareholder for nil consideration (i.e. a transfer that would otherwise result in a deemed dividend under Division 7A). Numerous private binding rulings exist that confirm that 328-450 'switches off' the application of Division 7A on a below market value transfer from a company to a non-corporate entity.

It is noted that directors owe various duties under the *Corporations Act 2001* (Cth) (e.g. the duty to act in good faith in the best interests of the company and for a proper purpose). This issue has been noted in various papers – however that issue is practically unlikely to be relevant in the case of where all shareholders agree on the restructure, and all creditors of the company are paid.

Non-corporates can claim the general 50% CGT discount, whereas corporate entities cannot. Thus, a restructure under the SBRR that involves a corporate entity to a non-corporate entity may change the ability of client to claim the general 50% CGT discount on a (distant) future sale.

Refer to case study #2 for an example of this in practice.

4.5 Where the SBRR is the only option

Situations may exist where neither the Small Business CGT Concessions nor the general CGT rollovers can apply. For example, this may be the case where:

- the transaction is not a transaction to which a general CGT rollover can apply; and
- the taxpayer fails the $6 million net asset value and aggregated annual turnover is more than $2 million (but less than $10 million).

In certain circumstances, the SBRR may be the only tax relief option available for a proposed restructure.

[8] Where consideration cannot be provided, other than shares in the interposed company.

4.6 'Refresh a trust'

The SBRR can be utilised to allow an existing discretionary trust to transfer assets to a new discretionary trust (a 'clean-skin trust'). This can be of benefit in situations where:

- the existing trust deed has no or limited powers or variation;
- there are different assets or activities within a single trust, and there is a desire to separate / segregate those assets / activities; or
- the trust is close to vesting.

There is debate on whether the trusts must make family trust elections. More on that issue below.

5. Traps and Pitfalls of the SBRR

Now – the bad and the ugly.

Undoubtedly the SBRR has unique benefits. However, as noted by the Board of Taxation:

> *"it is complex to apply in practice, imposes a high compliance cost, and has technical limitations which restrict its usefulness, all of which have led to a low user take-up."*

The main technical limitations are discussed below.

5.1 Issues with using Discretionary Trusts

The concept of 'ultimate economic ownership' does not gel well with a discretionary trust.

Various issues exist with the 'no change in individuals that hold ultimate economic ownership' test and the provision that was intended to help enable the SBRR apply to transactions involving discretionary trusts.

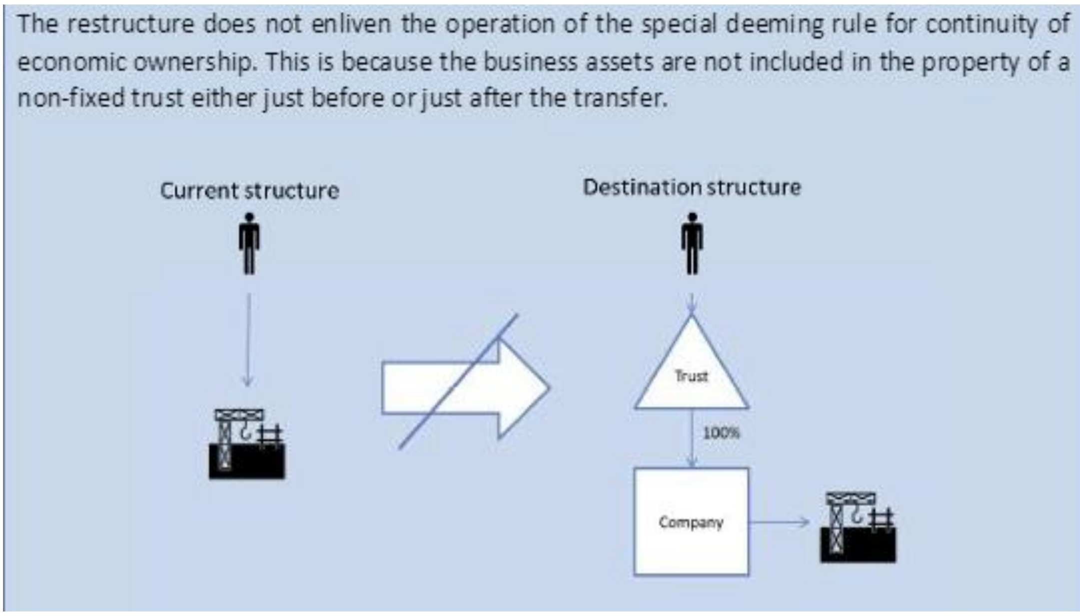
Unfortunately, the current SBRR rules (and how they have been interpreted by the ATO) makes it difficult for some taxpayers to restructure using the SBRR.

Those issues include the following.

5.1.1 Limitations of the Rule in Section 328-440: Indirect Transfers

One of the major limitations of the deeming rule in section 328-440 is that it requires the transferred assets to constitute <u>property of a discretionary trust</u> either just before or just after the transfer (or both). This means that the rule in section 328-440 can **only** be used where assets are either transferred **directly** to or directly from a discretionary trust. An 'indirect transfer', such as between two companies each owned by a discretionary trust, cannot meet this requirement.

As noted by the Board of Taxation in their March 2019 Review of Small Business Tax Concessions, the SBRR cannot apply to a sole trader moving to a company owned by a discretionary trust – as the business assets at no stage are property of a discretionary trust.



The restructure does not enliven the operation of the special deeming rule for continuity of economic ownership. This is because the business assets are not included in the property of a non-fixed trust either just before or just after the transfer.

See also *Private Binding Ruling 1052077111745* (issued 13 January 2023) for a recent example.

The above desired change from a sole trader to a company owned by a discretionary trust could be implemented via a two-stage transfer:

1. from the sole trader to a discretionary trust (in reliance on the SBRR); and
2. a subsequent company interposition (in reliance on Subdivision 122-A).

Having to rely on two separate rollovers is far from ideal and various risks regarding ‘back to back’ rollovers arise.

5.1.2 Limitations of the Rule in Section 328-440: Family Trust Elections

Where a transfer between two trusts is contemplated, generally reliance is sought on section 328-440. However, there may be situations where the test individual for the transferor trust is deceased, such that it is necessary for a different ‘test individual’ to be nominated for the discretionary trust on the transferor’s side. In those circumstances, the ATO considers that a proposed restructure cannot satisfy the alternative rule in section 328-440.

See *Private Ruling Binding 1052090178113* (issued 27 February 2023) for an example. Remarkably, that was the outcome despite the beneficiaries of the transferor trust being limited to individuals who are members of the family group of both the transferor trust and the transferee trust.

5.1.3 Discretionary Trusts: Must the Rule in Section 328-440 be used?

There is nothing in the wording of Subdivision 328-G that requires section 328-440 to be used. Section 328-440 is a provision that may assist in satisfying the requirement that the transaction does not have the effect of materially changing which individual has, or which individuals have, the ultimate economic ownership of the asset.

If a transaction does not have the above effect, it follows that the transaction can satisfy the SBRR without relying on section 328-440 –even if it involves discretionary trusts. Yet, the Commissioner of Taxation’s view (expressed at paragraph 107 of LCR 2016/3) is that a transfer of assets from or to a discretionary trust will generally not meet the requirements for ultimate economic ownership on their facts. In the author's view, that statement is contradictory to the Explanatory Memorandum (and in any event – neither the LCR nor the Explanatory Memorandum can supplant the words used in the legislation).

In this discussion it is worth emphasising that the SBRR does not require that the ultimate economic ownership be ascertained on either side of a proposed transaction. Rather, the rules forbid a change in the individual or individuals that have ultimate economic ownership.

Consider the following scenarios:

- **#1:** the transfer of business assets from a company (shares 50:50 owned by two discretionary trusts) to a new company (shares 50:50 owned by the **same** two discretionary trusts);
- **#2:** the transfer of business assets from a discretionary trust to new discretionary trust (with identical specified beneficiaries and an identical class of beneficiaries); and
- **#3:** the transfer of business assets from a discretionary trust to a new discretionary trust (within the family but with non-identical specified beneficiaries and a non-identical class of beneficiaries).

In relation to the above scenarios:

- it seems clear that Scenario #1 should meet the ultimate economic requirement (as the shares in both companies are owned by the same discretionary trusts in the same proportions). How could it not when the shareholders on both the transferor and transferee side are the same trusts? However, see *Private Binding Ruling 1052163582698* (issued 4 September 2023), where the ATO rules that such a transaction cannot qualify *"as it is not possible to attribute specific proportions to each individual within those discretionary trusts"*;[9]
- it seems clear that Scenario #2 should also meet the ultimate economic requirement (given that if all the beneficiaries are the same, how could there possibly be a change in the individuals who have ultimate economic ownership?). Here, the ATO's view is that unless the rule in section 328-440 is met, the ultimate economic requirement will not be met. See *Private Binding Ruling 1052128140038* (issued 19 June 2023) for an example where it is stated that *"the ultimate economic ownership test in paragraph 328-430(1)(c) cannot be satisfied."*
- in relation to Scenario #3, it seems strongly arguable that Scenario #3 should also meet the ultimate economic requirement (as if individual beneficiaries do not have any ultimate economic ownership in any event, then how does changing those beneficiaries affect ultimate economic ownership?)

The Private Binding Rulings outcomes in Scenario #1 and Scenario #2 seem directly inconsistent with the Explanatory Memorandum:

> *1.34 In some cases, non-fixed (discretionary) trusts may be able to meet the requirements for ultimate economic ownership on their facts. For example, a trust may be non-fixed for the purposes of the income tax law but,* ***because there is no practical change in which individuals economically benefit from the assets before and after the roll-over, there will not have been a change in ultimate economic ownership on the facts.***

[9] In this Private Ruling, it is stated that the portion of the share of the ultimate economic ownership of an asset held by a beneficiary of a discretionary trust is impossible to specify. Contrast this to the language used in Private Binding Ruling 1052195043880 where it is stated that beneficiaries of a discretionary trust cannot have ultimate economic ownership of the assets held by the trust.

5.2 Issues with the Genuine Restructure Requirement

It is somewhat ironic that a tax rollover provision which was designed (imperfectly) to allow transfers from individuals to discretionary trusts (enabling income splitting) and to allow assets from a company to be extracted tax free (without Division 7A consequences) could also contain a quasi-requirement that the proposed restructure cannot be ‘too tax driven’, or else the proposed restructure may not be a ‘genuine restructure’ after all.

Whether a restructure is considered a ‘genuine restructure’ is undefined and vague. No case law exists regarding the scope or nature of the term and the ATO’s interpretation of the term is relatively strict (discussed below). Practically, taxpayers must choose whether to:

- strictly adhere to the ATO’s views on what is a ‘genuine restructure’;
- undertake a proposed restructure with the knowledge and risk that the Commissioner may disagree on whether the transaction as a ‘genuine restructure’;
- rely on the safe harbour rule;
- decide that it is too hard and opt to rely on other rollovers, or not restructure at all.

Law Companion Guideline LCG 2016/3 provides further guidance on various aspects of the SBRR. LCG 2016/3 discusses the Commissioners views on what is considered a genuine restructure. LCG 2016/3 also contains a series of examples concerning situations which the Commissioner considers would be a genuine restructure of an ongoing business (Examples 1 to 4) and the situations which the Commissioner considers would **not** be a genuine restructure of an ongoing business (Examples 5 to 7).

The examples where the Commissioner does not consider that the genuine restructure requirement would be met illustrate the concerns the Commissioner has with the SBRR.

Example 5 (facilitating the economic realisation of business assets)

In example 5, a restructure is undertaken via the SBRR with the intention of selling the new business structure in 12 months time. Here, the concern is that the SBRR is being used to facilitate the economic realisation of business assets.

> *Willing buyers are prepared to purchase a business carried on by You Beaut Pty Ltd. However, the buyers do not want to purchase the company shares because they are concerned about undisclosed liabilities.*
>
> *Ben Silverfox is the sole shareholder of You Beaut Pty Ltd. He causes it to transfer its active assets to himself. You Beaut Pty Ltd and Ben assert this transaction is a 'genuine restructure of an ongoing business'.*
>
> *After 12 months have passed, Ben disposes of the assets to the buyers. Ben claims the general 50% CGT discount, which would not have been available to You Beaut Pty Ltd had it disposed of the assets directly to the buyers.*

Example 6 (inter-generational transfer of wealth)

In Example 6, a restructure is undertaken via the SBRR to split two businesses into separate entities. However, the ownership of those separate entities is passed to different family members within 3 years. Here, the concern is that the SBRR is being used to enable a tax-effective inter-generational transfer of wealth.

> *Nick owns all the shares in Holding Co a company that operates two restaurants, Fish and Chips. Nick has two sons and is looking to retire.*
>
> *Nick causes the company to transfer the active assets relating to Fish restaurant to Gone Fish Inc., a newly incorporated company that he also owns. The SBRR is claimed.*
>
> *Sometime later, but within three years, Nick retires and disposes of the shares in the Holding Co (which now holds the active assets of Chips only) to his first son and the shares in the new company to his other son, so that each of them can run their own restaurants separately. Nick cedes control to his sons as a result of his plan to retire.*

Example 7 (tax loopholes)

In Example 7, two restructures are undertaken via the SBRR. The first from a discretionary trust to a corporate entity (for consideration, in satisfaction of UPE's) and the second from the corporate entity to another trust (for no consideration, hence an extraction of company assets). Here, the concern is that the SBRR is being used as a 'tax loophole' by extinguish the UPE's on foot, but largely replicating the original structure.

> *Peterson Pauper is a successful business that has been operating through a trust (the Peterson Trust) since its commencement.*
>
> *Each year, the trustee of the Peterson Trust has made its corporate beneficiary, Peterson Pty Ltd, presently entitled to the income of the Peterson Trust.*
>
> *However, none of Peterson Pty Ltd's entitlements have been paid. Instead, the associated funds relating to the unpaid present entitlements (UPEs) have been retained for use in the Peterson Trust.*
>
> *Patricia, the controller of the group, causes the Peterson Trust to satisfy Peterson Pty Ltd's UPEs with the transfer of its active assets to Peterson Pty Ltd. It is assumed that the ultimate economic ownership requirement is satisfied. In effect, the business is transferred to Peterson Pty Ltd, and the SBRR is claimed.*
>
> *Peterson Pty Ltd in turn transfers those active assets to a newly established trust, the Patricia Family Trust, and the SBRR is claimed again. The Patricia Family Trust subsequently seeks to dispose of those assets, and transfer any related proceeds to Patricia as a capital distribution.*

Taxpayers and their advisors must ensure any restructure undertaken using the SBRR has sufficient commercial reasoning behind the decision (beyond tax, divestment of assets and estate planning).

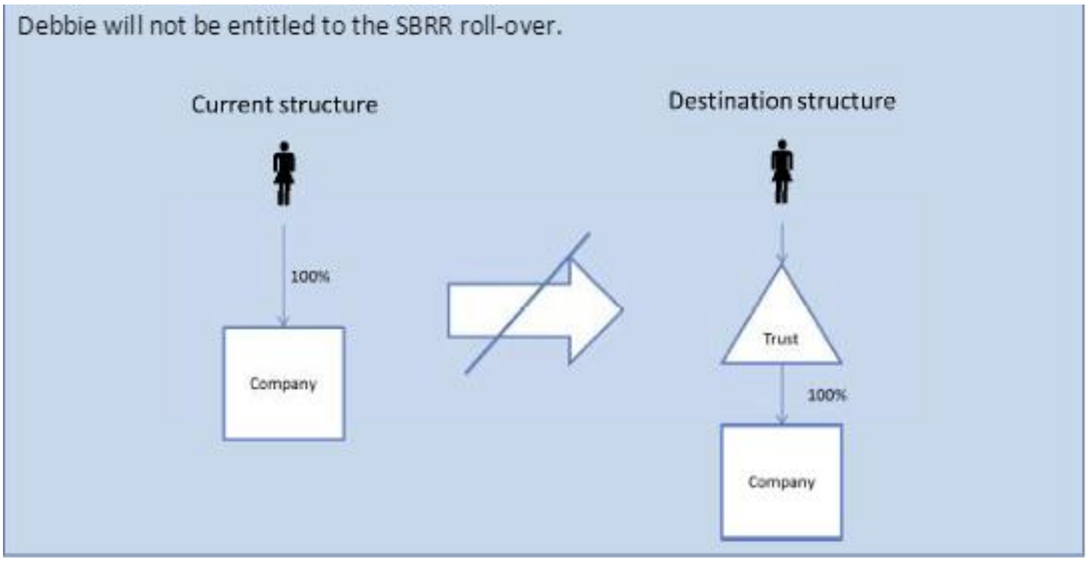
5.3 Transferring Shares

While shares (and units) can be active assets themselves (under subsection 152-40(3)), the issue is that paragraph 328-430(1)(d) may impose additional requirements, over and above the asset simply satisfying the 'active asset test'.

Firstly, the confusing aspect about paragraph 328-430(1)(d) is that there are three alternatives, depending on which of subparagraph 328-430(1)(b)(i) to subparagraph 328-430(1)(b)(iv) 'applies'. However, unless each party to the transfer is the same type (e.g. a small business entity, rather than a connected entity), then more than one subparagraph must 'apply'. Where two subparagraphs apply, how is it determined which of the alternatives must be met?

Leaving aside that technical issue, the consensus view appears to be that unless **both** the transferor and transferee are 'small business entities', the shares being transferred must satisfy subsection 152-10(1A). One requirement of that subsection is that the small business entity must carry on the business 'in relation to the CGT asset'. The correct view appears to be that a small business entity does not carry on the business in relation to the shares in that entity itself.

For this reason, the SBRR is not generally available for the transfer of ownership interests in business entities. This is noted by the Board of Taxation in their Review.[10] See the following example:



However, there are situations in which the transfer of shares or units could potentially meet the active asset requirement contained in the SBRR. For example, where both the transferor and the transferee are small business entities in their own right. In that case, subsection 152-10(1A) would not need to be satisfied and the 'normal' active asset test would apply to the shares being transferred.

For an example, see *Private Binding Ruling 1051401566911* (issued 17 September 2018). In that Ruling, a company (W Pty Ltd) transferred units (in the Y Trust, which owned commercial property) to a discretionary trust (the X Trust). W Pty Ltd carried on a business of manufacturing/fabricating of metal products and the X Trust would carry on a business of labour hire/provision of personnel services. It should also be noted that the cost base of the units was in excess of $1m, but the company was to transfer the units for nil consideration. It is not mentioned in the ruling itself, however by 'removing' corporate ownership, the transaction would appear to result in a more advantageous tax treatment if ever the commercial property were sold in the future.

5.4 Uncertainty No Case Law / Problematic Private Rulings

To date, no case law exists regarding any aspect of the SBRR. Coupled with a restrictive ATO interpretation of certain elements, this unfortunately means that there is real uncertainty about

[10] See paragraph 7.13.

whether a proposed restructure will qualify for the SBRR, and thus reluctance by advisors to recommend the SBRR. In that environment, one of the following options may be preferred:

- simply keeping the status quo;
- restructuring via the small business CGT concessions;
- restructure via a general CGT rollover.

When judicial consideration of the SBRR does occur, it may be put to the Court that given the legislated object in section 328-425 (to facilitate flexibility for owners of small business entities to restructure their businesses, and the way their business assets are held, while disregarding tax gains and losses that would otherwise arise), that SBRR provisions should be construed beneficially, rather than restrictively.

In that regard, the comments of the Full Federal Court in *Eichmann v Commissioner of Taxation* [2020] FCAFC 155 in the context of the small business CGT concessions will no doubt be referred to – most relevantly paragraphs [39] and [40], replicated as follows:

The beneficial nature of the small business relief is also discernible in the Guide to Div. 152, s. 152-1, which states that, "[t]o help small business", the small business concessions are available on satisfaction of the relevant conditions. ***Guides are of limited assistance in interpreting the 1997 Act, but they may be considered in "determining the purpose or object underlying [a] provision"****: s. 950-150(2)(a). We have considered s. 152-1 in this way in construing s. 152-40(1)(a).*

It follows that because s. 152-40(1)(a) is beneficial in nature, ***"its language should be construed so as to give the most complete remedy which is consistent "with the actual language employed" and to which its words "are fairly open":*** *Khoury v. Government Insurance Office of New South Wales [1984] HCA 55; (1984) 165 C.L.R. 622 at 638 per Mason, Brennan, Deane and Dawson JJ. In that respect, a beneficial construction of legislation may, in our view, legitimately influence constructional choices in a given case which arise from the use of generalised language to describe a necessary connection between two things; here those two things are the use of an asset and the carrying on of a business.*

5.5 Other Tax Consequences

Where the SBRR applies, the direct income tax consequences of a restructure are ignored. The same does not apply to other federal taxes (e.g. GST) or State taxes (e.g. duties). Those tax issues should be carefully considered.

In relation to the transfer of real property, the application of transfer duty is often a sticking point. However, depending on the State and transaction proposed, duty relief may be available.

5.6 Part IVA

Part IVA of the ITAA36 contains a series of anti-tax avoidance provisions to counter arrangements that would otherwise be legally valid for tax purposes. Part IVA provides the Commissioner of Taxation the power to cancel any tax benefit received by a taxpayer from entering into a 'scheme'. Broadly speaking, Part IVA applies where:

- there is a 'scheme' (i.e. any course of conduct, with or without omission);

- a tax benefit results from the scheme (e.g. income is less than what it ‘should have been’, because a CGT rollover applies where it ‘should not’); and
- the scheme was entered into for the objective dominant purpose of obtaining a tax benefit.

While a detailed examination of Part IVA is beyond the scope of this paper, it is worth highlighting that Part IVA should always be considered in the context of a restructure, particularly the SBRR. For example, the Commissioner notes in LCG 2016/3 that Part IVA can still apply in appropriate cases to restructures notwithstanding that the safe harbour rule is satisfied.

6. Small Business CGT Concessions and Restructures

The small business CGT concessions are contained in Division 152 and broadly were designed to provide CGT relief to small business owners on the disposal of business assets to a third-party.

The small business CGT concessions are not a rollover per se. Nor were they designed with a policy intention regarding facilitating business restructures. Notwithstanding, the small business CGT concessions are a powerful tool to consider in the context of a small business restructure.

6.1 Basic Conditions

To have access to any of the concessions, a taxpayer must firstly meet certain 'basic' conditions in Subdivision 152-A. Subsection 152-10(1) of the ITAA97 provides that, to reduce or disregard a capital gain, the following conditions must be met:

a) *a CGT event happens in relation to a CGT asset of yours in an income year;*

Note: This condition does not apply in the case of CGT event D1: see section 152-12.

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 CGT small business entity for the income year and the CGT asset is an interest in 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 (see section 152-35).*

It follows that in the majority of cases, a restructure will satisfy the 'basic conditions', where:

- the transferor is either a 'CGT small business entity' or satisfies the 'maximum net asset value test'; and
- the CGT asset in question satisfies the active asset test.

More complex rules apply in several scenarios. For example:

- where passively held assets are being disposed of (but that are used in either a related partnership, by the taxpayer's affiliate or by a connected entity);
- where earnout rights are concerned; and
- where the CGT asset in question is either shares in a company or an interest in a trust (see subsection 152-10(2)).

The Concessions are made up of the following four separate tax concessions, which taxpayers can generally claim in any manner they wish. Below is a brief summary of the concessions available.

6.2 15-year Exemption (Subdivision 152-B)

The 15-Year Exemption is by far the most effective concession and takes priority over other concessions. The 15-Year Exemption disregards the entire capital gain. This concession can apply to individuals, companies and trusts (subject to specific criteria). To claim the 15-Year Exemption, the taxpayer must satisfy the following additional conditions:

- the taxpayer must have been continuously owned the CGT asset for the 15-year period ending just before the CGT event;
- there must be an individual (significant individual where the taxpayer is a trust or company) that it is 55 years of age or over at the time of the CGT event, and the CGT event happens 'in connection' with their retirement;[11] and
- if the CGT asset in question is shares or an interest in a trust, the entity must have had a significant individual for a total of at least 15 years.

6.3 Small Business 50% Reduction (Subdivision 152-C)

Under the Small Business 50% Reduction concession, the taxpayer can choose to reduce the amount of the capital gain by 50% (in addition to the general 50% CGT discount, if applicable). No further criteria apply other than the taxpayer electing to use this concession.

In certain circumstances (particularly when a company or unit trust is the relevant taxpayer), there may be good reasons to support not choosing to apply this concession. In general, this will be where it is desired to apply the Retirement Exemption to a larger capital gain, and avoid having an untaxed capital gain left (particularly in a company).

6.4 Small Business Retirement Exemption (Subdivision 152-D)

If a taxpayer is eligible and decides to use the Retirement Exemption, the taxpayer can disregard a further $500,000 per applicable individual. If the individual in question is under 55 years of age, the disregarded capital gain must be contributed to a complying superannuation fund.

If the taxpayer is a trust or company, it may be possible to disregard up to $4,000,000 of a capital gain using this concession (as an entity can theoretically have up to eight 'CGT concession stakeholders').

6.5 Small Business Roll-Over (Subdivision 152-E)

The Small Business Roll-Over can be chosen for a capital gain that has not otherwise been disregarded or reduced under any of the previous concessions.

If the Small Business Roll-Over is chosen, the remaining capital gain is disregarded (however large), and:

[11] Alternatively, that the individual (or significant individual) is permanently incapacitated.

- CGT event J5[12] will occur two years after the initial CGT event, if the taxpayer does not acquire a replacement business asset within the period commencing one year before or two years after the date of the initial CGT event (the Replacement Period); or
- CGT event J2[13] may occur a later time, if there is a requisite change to the replacement business asset. To the extent no change occurs, the capital gain is will continue to be disregarded (potentially indefinitely).

Where a trust or company applies Subdivision 152-E, an interesting issue arises where the trust or company no longer exists at the time that CGT event J5. For example, because the entity is deregistered / liquidated (in the case of a company) or vests (in the case of a trust) at some point in time between applying the Small Business Roll-Over and CGT event J5 occur.

The legislation does not contain any specific provision to deal with this situation. In contrast, section 152-420 exists where an individual who has chosen the roll over dies during the same period.

In the context of the obligation on trustees and agents to retain sufficient funds to pay tax (section 254 of the ITAA36), *Commissioner of Taxation v Australian Building Systems Pty Ltd (In Liquidation)* [2015] HCA 48 makes it clear that a trustee's obligation to retain funds only arises upon an assessment or deemed assessment being made, and not before that time.

This issue has been known about for some time and it is perhaps surprising that a Taxpayer Alert does not exist on the issue.

[12] Section 104-197 of the ITAA97. Alternatively, CGT event J6 in the case that the cost of acquisition of the replacement asset or amount of fourth element expenditure, or both, are not sufficient to cover disregarded capital gain.
[13] Section 104-185 of the ITAA97.

7. Opportunities within the Small Business CGT Concessions

Many of the opportunities within the Small Business CGT Concessions are well known. In the context of a business restructure, the opportunities available include the following.

7.1 Cost Base Uplift / Use It or Lose It

Generally, under a CGT rollover the transferor will inherit the transferee's cost base in the transferred asset (e.g. in goodwill, which is often has no cost base where a business is started from scratch).

The Concessions are not a CGT rollover. Using the Concessions will 'reset' the cost base of the transferred assets, generally to their current market value. Where the asset has a significant capital gain, this provide an 'uplift' to the assets cost base.

This uplift may significantly lessen the capital gain arising on a much later third-party disposal of the transferred assets. This is particularly critical where the taxpayer may in the future not be eligible for the Concessions. For example, due exceeding the $6 million maximum net asset value test in the future (but presently satisfying that test).

7.2 Extraction – Companies and Unit Trusts

Where the 15-Year Exemption applies, there is the ability to extract funds from a company structure without resulting in a taxable dividend to the shareholders.

Where a unit trust is concerned, a similar ability exists (to extract funds without triggering CGT under CGT event E4).

7.3 Loan Receivable

The transferor may transfer the business assets to the transferee for a full market value purchase price, with that price to be paid on vendor finance terms.

Where the transferee is a company (e.g. moving to a two-tiered structure or from a discretionary trust to a company), the benefit of this is essentially that the transferor company can derive income from the restructured asset, pay corporate tax, and then repay the vendor finance amount. In some instances, the transferor company may seek to borrow funds externally to pay that vendor finance amount, with the business owner then using the funds to pay personal debt (e.g. non-deductible debt against a main residence).

Alternatively, it may that unpaid present entitlements exist between a discretionary trust and a company that can be satisfied as a result of the restructure.

7.4 Tax Consolidation

Where a taxpayer wishes to move into or form a tax consolidated group, allocable cost amount (ACA) calculations must be performed. Broadly, the ACA must be calculated and then allocated amongst the assets of the consolidated group. Assets are split into two classes, namely 'retained cost base assets' (that retain their cost base – such as cash and loan receivables) and 'reset cost base assets' (that have their cost base 'reset' – such as goodwill, depreciating assets and real property).

The first step in calculating ACA is to take the existing cost base in membership interests in the head company. Issues may exist in the allocable cost amount process, resulting in unfavourable cost base pushdown implications for 'reset cost base assets', or worse, an immediate CGT event where there is insufficient ACA to allocate to retained cost base assets (see CGT event L3).

In general, given that the Concessions are not a rollover and provide full market value cost base in the assets transferred, there should be sufficient ACA if forming a tax consolidated group following a restructure using the Concessions. In contrast, that outcome may not occur if a tax consolidated group is formed in other scenarios.

7.5 Superannuation Contributions

The Concessions can permit significant contributions to superannuation (that are not subject to the non-concession contributions cap). The sum permitted under the retirement exemption is $500,000. The sum permitted under the 15-year exemption may be as high as $1.705m.[14] This figure is one of the rare instances of indexation within the Concessions landscape.

It should be noted that it is not required for the sale proceeds themselves to be contributed to superannuation. For example, business real property separately owned by the taxpayer could be contributed as an in-specie contribution (either fully as a contribution, or partially as a contribution and partially as a sale).

These limits (particularly for the 15-year exemption) are often the only way that existing business real property (held outside of superannuation) can be contributed to superannuation.

7.6 Flexibility

Unlike the SBRR (or the general CGT rollovers), the small business CGT concessions impose no requirements whatsoever regarding the identity of the transferor or the 'form' of the restructure. It follows that a restructure using the Concessions can generally be more flexible than one undertaken via the SBRR or the general CGT rollovers.

Issues such as the 'genuine restructure' and 'ultimate economic ownership' requirements do not need to be considered.

[14] The lifetime cap for the 2023-24 income year is $1,705,000.

8. Traps and pitfalls in applying Small Business CGT Concessions

The Concessions are full of technical and complex issues that must be carefully navigated – particularly in the context of a restructure where there may be alternative restructuring options available.

The discussion below is intended to address some of the more common technical traps and pitfalls that arise in the context of applying the Concessions to a business restructure.

8.1 15-year exemption – 'in connection with retirement'

The 15-Year Exemption is by far the most effective concession. Where larger capital gains are concerned, relying on the 15-Year Exemption may be the only way that the transaction is tax-free (rather than being concessionally taxed).

For the 15-Year Exemption to apply, the CGT event must be **'in connection with your retirement**' (in the context of an individual) or in connection with a significant individual's retirement (in the context of a company or trust).[15]

In most cases where a sale to a third party occurs, it is reasonably straightforward to determine whether the sale of the asset is in connection with an individual's retirement.[16]

However, where a restructure occurs (perhaps as part of an individual's retirement or succession plan), the exercise is much more complex.

8.1.1 Meaning?

The phrase 'in connection with your retirement' is not defined or explained elsewhere in the ITAA97 or any of the relevant explanatory memorandum, although in general legal terminology a phrase using the words 'in connection' typically requires some degree of causal connection between the two things (in this case, the CGT event and retirement).

In the absence of any express legislative guidance regarding the length of the proverbial string that must connect the CGT event and the relevant individual's retirement, practitioners naturally look towards the Courts for interpretive guidance. However, despite the 15-Year Exemption being such a fundamental part of the small business CGT concessions (and being around for 20+ years), to date, there has been no case law (either in the AAT or Federal Court) that has closely examined the meaning of 'in connection with retirement' in the context of the 15-Year Exemption.

[15] Alternatively, the 15-Year Exemption can apply where the individual or significant individual is 'permanently incapacitated'.
[16] Note that the situation does become more complex where a commercial arrangement requires the former business owner to stay on for a long period under the new owner, or where taxpayer retains an equity stake.

Furthermore, the ATO has not released any formal public rulings or taxation determinations outlining the Commissioner's interpretation of the requirement. Currently, the only public ATO guidance is found under the 'Small business 15-year exemption' webpage,[17] which states:

- a CGT event happening in connection with an individual's retirement depends on the circumstances of each case;
- there would need to be at least a significant reduction in the number of hours the individual works or a significant change in their present activities to be regarded as a retirement; and
- the timing may precede or proceed actual retirement.

Various private binding rulings also exist regarding the 'in connection with retirement'. While those rulings should be taken with a grain of salt, some interesting ruling outcomes have emerged in recent times.

8.1.2 Funds for Retirement?

A review of the private binding ruling register reveals mixed, and often inconsistent results regarding the circumstances in which the ATO will consider a restructure to be sufficiently connected with an individual's retirement.

For example, see *Private Binding Ruling PBR 1051634024657* (issued 21 February 2020). In that PBR, the ATO held that Company A was not entitled to apply the 15-Year Exemption to a family restructure transaction (parents to children). This was on the basis that, at the time of the transaction, the parents had already completely ceased to be involved in the business. For that reason, the ATO was not satisfied that the transaction was connected with a concurrent 'substantial reduction in the activities and hours worked' by the parents.

In recent years, a strand of private rulings has emerged where a wider interpretation of 'in connection with retirement' appears to be accepted. Those recent rulings appear to suggest that:

- a transaction may be 'in connection with retirement' if the proceeds arising from the transaction are to be **used** to provide funds for a person's retirement; and
- a greater acceptance that a transaction (particularly real property previously used in a related person) is 'in connection with retirement', despite the relevant person having ceased active business activities many years prior.

The below discussion comes with a reminder of the ATO's disclaimer on edited private rulings:

> *It is not binding and provides you with **no protection** (including from any underpaid tax, penalty or interest). In addition, this record is **not an authority for the purposes of establishing a reasonably arguable position** for you to apply to your own circumstances.*[18]

[17] Australian Taxation Office, Small business 15-year exemption (Web Page, 18 February 2024) <https://www.ato.gov.au/business/income-and-deductions-for-business/concessions,-offsets-and-rebates/small-business-cgt-concessions/small-business-15-year-exemption/>.

[18] Note that there is a question mark about whether this statement is in fact correct. The author is not aware of any Court conclusively determining that the edited private ruling register is not an authority (despite the disclaimer stated by the ATO). Reference should also be had to Hill J at Paragraph 112 of *Walstern v Commissioner of Taxation* [2003] FCA 1428.

8.1.3 Recent Private Rulings

In *Private Binding Ruling PBR 1051613162467* (Issued 26 February 2020), the ATO considered the application of the 15-year exemption in circumstances where the relevant taxpayer was not employed and did not intend to ever be employed again in the future at the time when the CGT event was to occur. The ATO concluded that the CGT event occurred in connection with the taxpayer's retirement, noting that:

> *The provisions relating to the small business 15-year exemption do not define what is meant by the phrase 'in connection with your retirement', nor does it give any indication of the degree of retirement required in order to take advantage of this concession.* ***It could be argued that the phrase 'in connection with your retirement' means that the capital gain arising from the disposal of active assets is to be used to provide funds for a person's retirement rather than to precipitate retirement at the time of the CGT event. The words used in the EM support this interpretation.***
>
> *It is not necessary for there to be a permanent and everlasting retirement from the workforce. However, there needs 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 'in connection with your retirement' for the purposes of paragraph 152-105(d) of the ITAA 1997.*
>
> *The retirement does not need to occur immediately following the event, however whether a particular case satisfies the conditions depends very much on the facts of the case.*
>
> *In this case the disposal of Person A's share of the Real Estate will be in connection with their retirement as they have ceased working and will live off the proceeds of the sale. The period of time taken to dispose of the Real Estate does not change the fact it was in connection with their retirement.*

In *Private Binding Ruling PBR 1052110338557* (Issued 21 April 2023), the ATO considered the application of the 15-year exemption in circumstances where the relevant taxpayer was a company that was transferring a property to a related discretionary family trust. The ATO concluded that the CGT event occurred in connection with the taxpayer's retirement, noting that:

> *The provisions relating to the small business 15-year exemption do not define what is meant by the phrase 'in connection with a taxpayer's retirement', nor does it give any indication of the degree of retirement required in order to take advantage of this concession.*
>
> ***The phrase 'in connection with retirement' infers that the capital gain arising from the disposal of active assets is to be used to provide funds for a person's retirement rather than to precipitate retirement at the time of the CGT event. The words used in the EM support this interpretation.***

In *Private Binding Ruling PBR 1052137481839* (Issued 7 July 2023), the ATO considered the application of the 15-year exemption in circumstances where the relevant taxpayers had previously ceased their respective employment activities and intended to use the capital proceeds for their retirement. The ATO concluded that the CGT event occurred in connection with the taxpayer's retirement.

In doing so, the ATO provided a more detailed analysis of the phrase 'in connection with', noting that:

> *The legislation does not provide a specific definition of the word 'retirement' for the purpose of subparagraph 152-110(1)(d)(i) of the ITAA 1997. Consequently, it takes its ordinary meaning.*

The Macquarie Dictionary (online version, downloaded 7 August 2019) defines 'retirement' to mean 'removal or retiring from service, office, or business, especially in reaching the end of one's working life'.

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.****'*

The above interpretations (assuming correct) assist in applying the 15-Year Exemption to a restructure.

8.1.4 Future Proofing Restructures

The grey concept of ‘in connection with retirement’, the lack of judicial guidance and conflicting ATO private binding rulings serves to demonstrate the benefits of seeking a private binding ruling in cases with complex or uncertain applications, particularly in the context of a restructure using the Concessions.

Taxpayers who have already obtained favourable private binding rulings on a subject are entitled to rely on that decision regardless of whether the ATO subsequently adopts a different position.

Taxpayers may also wish to consider preparing and documenting a fulsome and specific retirement plan where an individual or entity is seeking to apply the 15-Year Exemption in the context of a restructure.

8.2 Complexity with the 80% look-through test for shares

Complexity can arise in forming a sufficient level of comfort that shares or units being restructured satisfy the active asset test.

A share in Australian resident company (or an interest in a trust) is considered an active asset (at a particular time) if the below requirements in subsection 152-40(3) of the ITAA97 are met:

> *(3) A *CGT asset is also an active asset at a given time if, at that time, you own it and:*
>
> *(a) it is either a *share in a company that is an Australian resident at that time or an interest in a trust that is a *resident trust for CGT purposes for the income year in which that time occurs; and*
>
> *(b) the total of:*
>
> *(i) the *market values of the active assets of the company or trust; and*
>
> *(ii) the market value of any financial instruments of the company or trust that are inherently connected with a business that the company or trust carries on; and*
>
> *(iii) any cash of the company or trust that is inherently connected with such a business;*
>
> *is 80% or more of the market value of all of the assets of the company or trust.*
>
> (**80% Test**)

For the 80% Test to be meet, the following calculation is considered:

$$\frac{\text{market value of active assets} + \text{cash and financial instruments (inherently connected)}}{\text{market value of all company or trust assets}}$$

The active asset test requires a CGT asset to be an active asset for at least half a particular period, usually the ownership period. Thus:

- the 80% test itself must be met for at least half that period;

- calculations to be performed on a periodic basis (e.g. annually) to determine whether the 80% test is met at a particular time;
- those calculations will need to be based on the market value of the entities assets on the relevant test dates. While this is relatively straightforward for physical assets, it can be more challenging for intangible assets such as goodwill; and
- in relation to cash and financial instruments, a judgmental call needs to be made on whether that cash or financial instrument is 'inherently connected' with the business. For example, trade debtors should be inherently connected with the business. Loans to shareholders are unlikely to be inherently connected with the business. In relation to large cash balances, difficultly arises to determining 'how much' of that cash is inherently connected with the business. In relation to term deposits, see:
    - *Private Binding Ruling PBR 89912* (Issued 15 October 2009): where certain term deposits were 'inherently connected', but those term deposits were excluded under paragraph 152-40(4)(e) on the basis that they were financial instruments whose 'main use' was to derive interest;
    - *Private Binding Ruling PBR 1012825386023* (Issued 17 June 2015): where certain term deposits were 'inherently connected', and no consideration was given to the deriving interest exclusion; and
    - *Private Binding Ruling PBR 1011702973663* (Issued 5 April 2011): where consideration was given to the deriving interest exclusion, and it was determined that the main use of the financial instruments was not to derive interest but instead to be used directly in the course of the carrying of business activities.

The 80% Test is subject to two concessionary measures.[19] Those measures in essence provide *some* flexibility in terms how often testing is required and temporary failures.

Unfortunately, there is very little guidance (either from cases or the ATO) regarding the application of either of these rules. The general intent is to make it easier to meet the 80% Test, however it is unclear exactly how far this extends.

8.3 Individuals below 55 years of age

Where the individual or significant individuals in question are below the age of 55, the 15-year Exemption cannot apply. If applying the Retirement Exemption and the individual or significant individuals in question are below 55 years of age, payments must be made to a complying superannuation fund.

In the case of a business restructure, there can be little desire to make large contributions to superannuation. Issues can also arise if the capital gain in question is over $2 million and therefore, the application of the 50% general CGT discount, Small Business 50% Reduction and one single application of the Retirement Exemption ($500,000) will not reduce the capital gain to $nil.

In situations where the relevant business owners or operators are below 55, consideration should be given to the following:

- the 55 years of age requirement applies at the time of making the choice to apply the retirement exemption, and not at the time of the CGT event (potentially up to 21 months difference);
- it is possible to first claim the Small Business Roll-Over. If no replacement business asset is acquired within the Replacement Period (generally commencing one year before the CGT event

19

and ending two years after the CGT event), the Retirement Exemption can be claimed on the resulting gain arising under CGT event J5. In other words, an individual could be as young as 52 at the time of the restructure, yet have no requirement to make a payment to superannuation;

- in the context of a capital gain made by a trust, whether there are discretionary beneficiaries that are over 55 years of age and may qualify as significant individuals (e.g. by virtue of the trust making distributions to them); and
- finally, claiming the Small Business Roll-Over and acquiring a 'replacement business asset' within the Replacement Period. If such an asset is acquired with a cost equivalent to the capital gain being deferred, the capital gain can be deferred until the replacement asset no longer qualifies as a replacement business asset.[20] The 'replacement business asset' could perhaps even be existing restructured assets associated with the business in question (e.g. land, factory, plant & equipment, an equity interest in a company or trust) or newly acquired assets.

8.4 MNAV Issues

An entity satisfies the maximum net asset value test if, just before the CGT event, 'the net value of the CGT assets' of the entity[21] do not exceed $6 million. Section 152-20 provides that the 'net value of the CGT assets' of an entity is determined by working out the 'market values' of the CGT assets, less liabilities relating to those assets and various provisions.

Implementing a restructure, where the taxpayer and advisors have formed the view that the MNAV test has been satisfied, but that the MNAV test was actually failed, can be catastrophic.

Here are just some of the MNAV issues that may arise:

- disputes over the market value (or failure to obtain independent written values at all);
- failure to include 100% of an entities value where that entity is connected with the taxpayer (e.g. due to a 40% ownership interest);
- failure to consider capital distributions made by a discretionary trust (in the context of determining what individuals may be connected with a discretionary trust);
- entirely excluding a main residence from MNAV tests in situations where a taxpayer has derived assessable income from their main residence at any previous point in time (including renting);
- excluding assets in situations where a taxpayer's asset is not being used **solely** for the personal use and enjoyment of the individual; and
- excluding a spouses business assets, in circumstances where a taxpayer's spouse is deemed to be an affiliate under section 152-47 (generally occurring where business property is owned and used in a business, but that the entities are not linked unless spouses are deemed to be affiliates).

[20] i.e. until CGT event J2 occurs.
[21] Plus connected entities and their affiliates.

9. Case Studies

9.1 Case study 1 – Discretionary trust to Company Restructure

9.1.1 Facts

Mary carries on a successful business via a discretionary family trust (the **Blue Trust**). The business commenced in 2004 (20 years ago).

Historically, the Blue Trust has distributed some of its profits to Green Pty Ltd. There exists an unpaid present entitlement between the Blue Trust and Green Pty Ltd which was put on Division 7A terms in reliance on *Taxation Determination TD 2010/3*. The UPE current balance is $2 million.

The shares in Green Pty Ltd are owned by another discretionary family trust that Mary controls (the Red Trust).

The funds representing the above UPE have largely been used by the Blue Trust to purchase the business premises on which the business operates.

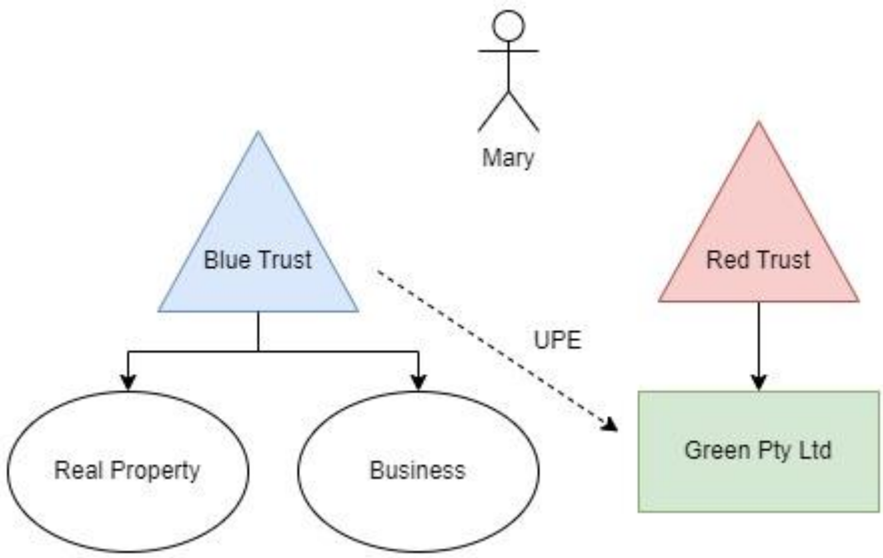
The turnover of the business for FY2023 was $5 million.

The business is independently valued at $3 million. The value of the property is $2 million.

Separately to the above, Mary mentions that she and her two siblings are beneficiaries of a testamentary trust, established on her late father's passing.

Mary is 56 years old.

Current structure



9.1.2 Objectives

Mary's business succession plan to is slowly divest the business to new equity partners.

While the discretionary trust has worked well in past, it is not fit for the future as the business needs more working capital and the ability to admit new equity partners.

Furthermore, Mary has recently been advised of the asset protection risks of owning real property in the trading entity.

In summary Mary's objectives include:

- Restructure the business into a company.
- Separate ownership of the property and the business.
- Do not trigger any tax liabilities in the process.

9.1.3 Proposed Restructure

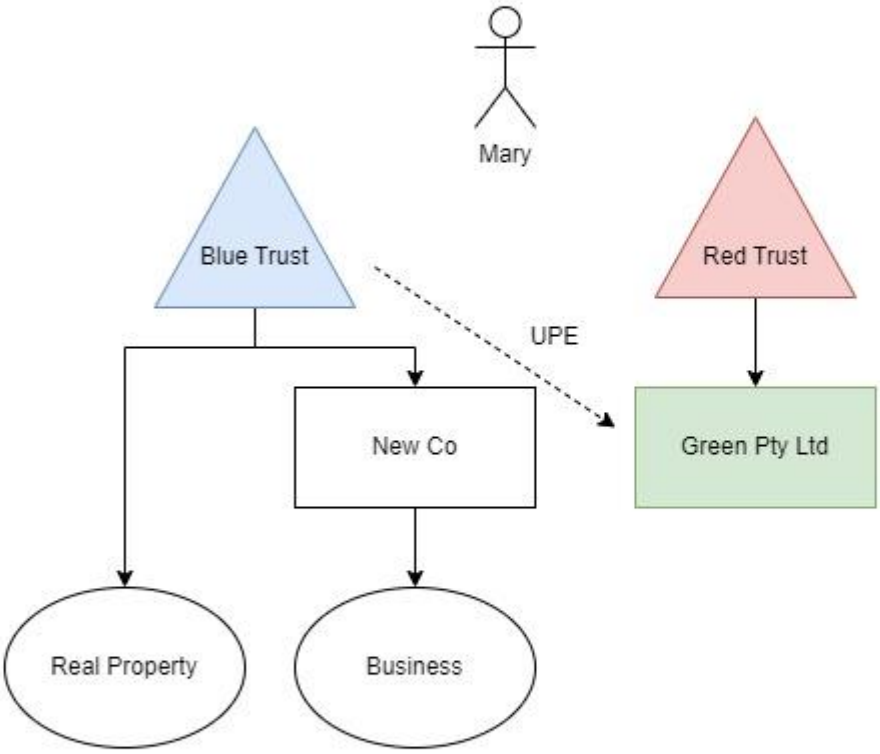
In Mary's situation, there are (at least) three different ways the proposed restructure can occur - and three different CGT deferral mechanisms.

Option 1 – via Subdivision 122-A Rollover

Under a subdivision 122-A rollover, a new company would need to be incorporated (Green Pty Ltd could not be used – given that it has valuable assets and is owned by the Red Trust).

The Blue Trust would transfer its business to New Co. In consideration, New Co would allot shares in itself to the Blue Trust (generally a large number of shares).

Option 1



Tax consequences include:

- capital gain or loss disregarded;
- trust's cost base in shares equal to costs bases of the business assets less liabilities; and
- company's cost base in business assets is inherited.

Issues to note:

- relatively easy to qualify – no need to consider turnover or net assets

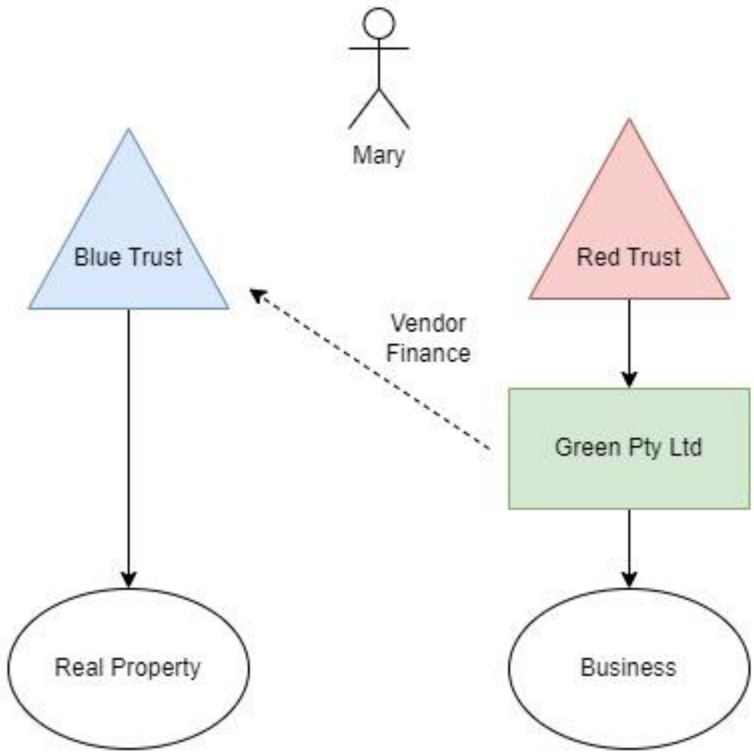
- is there a need to obtain a written valuation?
- inability to deal with UPE to Green Pty Ltd as transaction cannot be for consideration. UPE between the Blue Trust and Green Pty Ltd remains.
- no cost base step up on either the business assets or the shares.
- no preservation of 15-year time period if business sold in the future.

Option 2 – via SBRR

Under an SBRR, the Blue Trust could transfer its business directly to Green Pty Ltd (rather than necessarily requiring a new company to be incorporated). That transaction could be for consideration.

Selling the business for a sum of $3 million would mean that the Green Trust's obligation to pay the UPE's ($2 million) could be entirely offset against this amount (i.e. the UPE's cleared). The remaining $1 million would be owed by Blue Pty Ltd and could be repaid to the Green Trust over time.

Option 2



Tax consequences include:

- all direct income tax consequences are disregarded;
- Green Pty Ltd's cost base in business assets is inherited from the Blue Trust (cost base of CGT assets, cost for revenue assets); and
- the Red Trust's cost base in Green Pty Ltd would remain as is (likely nominal).

Issues to note:

- this option would enable Mary to separately deal with the ownership of the business (now owned by the Red Trust) and the ownership of the property (owned by the Blue Trust) – e.g. for estate planning purposes.
- the restructure would not reset acquisition timing for the 15-Year Exemption (from the perspective of the company selling the business in the future, **but not** the shareholders selling shares in the company in the future).

- turnover threshold ($10 million) will be met. No need to consider the $6 million maximum net asset value test (required under Option 3).
- allows for UPE's to Green Pty Ltd to be satisfied, and future benefit of loan receivable. Need to obtain written valuation to ensure that the consideration ascribed ($3 million) is reflective of market value.
- **Genuine Restructure?** While restructuring from a discretionary trust trading to a trading company would satisfy many of the factors referred to in the Explanatory Memorandum on what is a 'genuine restructure', the risk is that the restructure could be seen as a preliminary step to facilitate the economic realisation of assets. Further, the safe harbour rule will not be available if there is a change in shareholders within a three-year period. While it is arguable that the proposed transaction would be a genuine restructure anyway, to reduce the risk of the genuine restructure requirement being failed, the safest course would be to rely on the safe harbour (i.e. no changes in shareholding within a three year period).
- **Change in Ultimate Economic Ownership?** Given that the proposed restructure involves a direct transfer from a discretionary trust, the alternative deeming rule in section 328-440 should be available as long as the Green Trust and the Red Trust make family trust elections specifying Mary as the test individual.

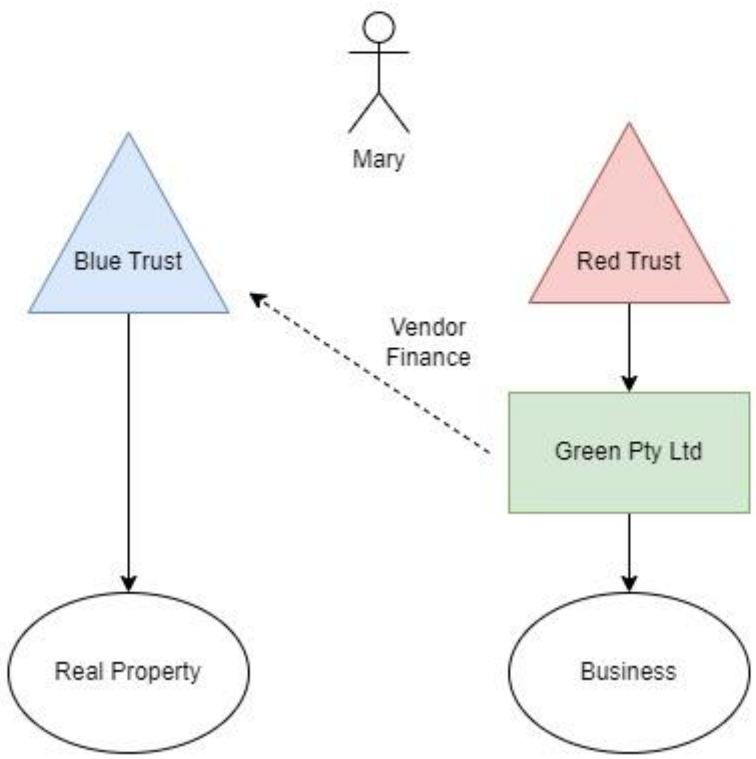
Option 3 – Claim Small Business CGT Concessions

Transaction wise, the option of claiming the small business CGT concessions would look identical to Option 2.

The Green Trust could transfer its business directly to Blue Pty Ltd (rather than necessarily requiring a new company to be incorporated). That transaction could be for consideration.

Selling the business for a sum of $3 million would mean that the Green Trust's obligation to pay the UPE's ($2 million) could be entirely offset against this amount (i.e. the UPE's cleared). The remaining $1 million would be owed by Blue Pty Ltd and could be repaid to the Green Trust over time.

Option 3



Tax consequences include:

- capital gain or loss is disregarded;
- Green Pty Ltd's cost base in business assets is stepped up to their current market value; and
- the Red Trust's cost base in Green Pty Ltd would remain as is (likely nominal).

Issues to note:

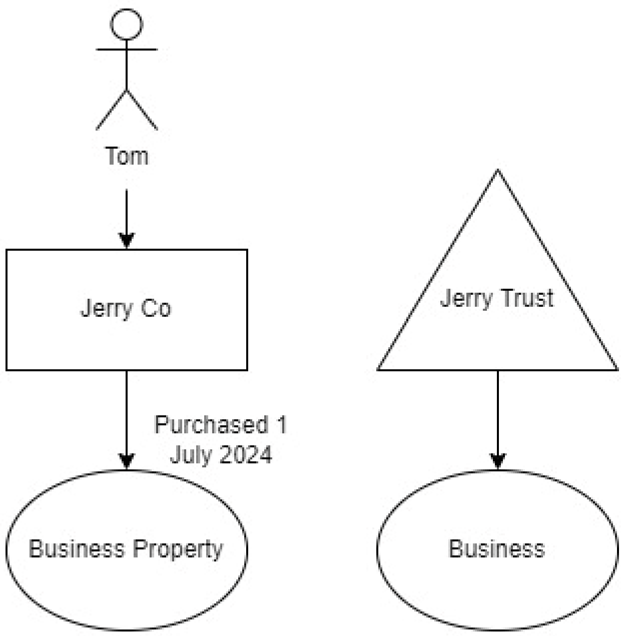
- this option would enable Mary to separately deal with the ownership of the business (now owned by the Red Trust) and the ownership of the property (owned by the Blue Trust) – e.g. for estate planning purposes.
- the turnover threshold ($2 million) will be failed. Reliance will need to be placed on the $6 million net asset value test. Consideration will need to be given to whether the testamentary trust (or other entities) will be included in Mary's maximum net asset value test calculations.
- assuming the basic conditions are met, consideration would need to be given to whether the 15-Year Exemption could apply. This would require the restructure to be 'in connection' with Mary's retirement.
- the small business CGT concessions will only provide relief in respect of CGT assets. Tax issues may arise with other assets being transferred (e.g. trading stock and depreciating assets).
- no issues regarding 'genuine restructure' or 'ultimate economic ownership'. Family trust elections would not be necessary and equity divestment in Green Pty Ltd could take place within three years (or even immediately on restructure).

9.2 Case Study 2 – Company to Discretionary Trust

9.2.1 Facts

- Tom runs a successful business.
- Tom has built up significant profits through a company. Tom owns 100% of the shares in the company (**Jerry Co**).
- On 1 July 2024, Jerry Co buys a commercial property in Victoria for the sum of $5 million. The property is used by Tom in a related business venture (via a discretionary trust – the Jerry Trust).
- 12 months later, Tom meets a new tax advisor – Rahul (the former one wasn't a Chartered Tax Advisor).
- Rahul advises Tom that he is poorly structured, both from a tax and risk perspective, and that ideally, the commercial property should be owned in a separate discretionary trust. Tom has no plans to sell the property any time soon, but recognises that one day it will be sold.

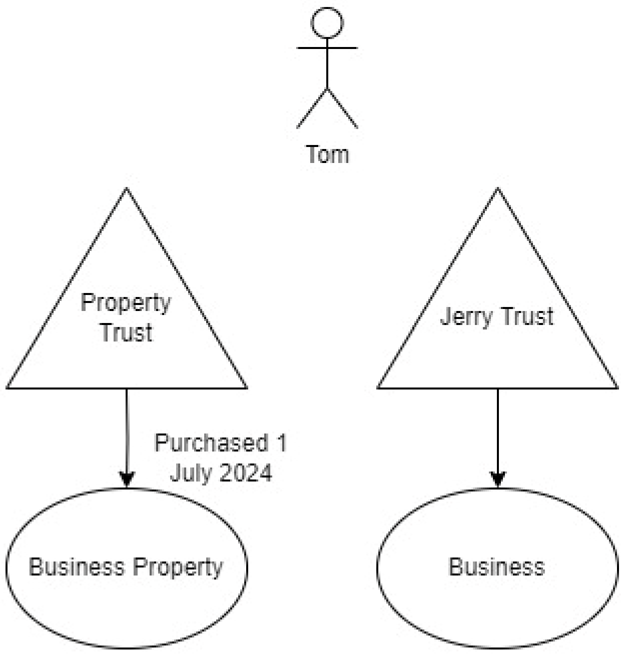
Current Structure



9.2.2 Proposed Restructure

- A new discretionary family trust is established (**Property Trust**). A family trust election is made in favour of Tom.
- Jerry Co transfers the property to the Property Trust for $nil consideration in reliance on the SBRR.

Proposed Restructure



- SBRR issues to work through:
    a. aggregated turnover;
    b. active asset;
    c. genuine restructure; and
    d. ultimate economic ownership.

9.2.3 Tax (and Duty) Consequences

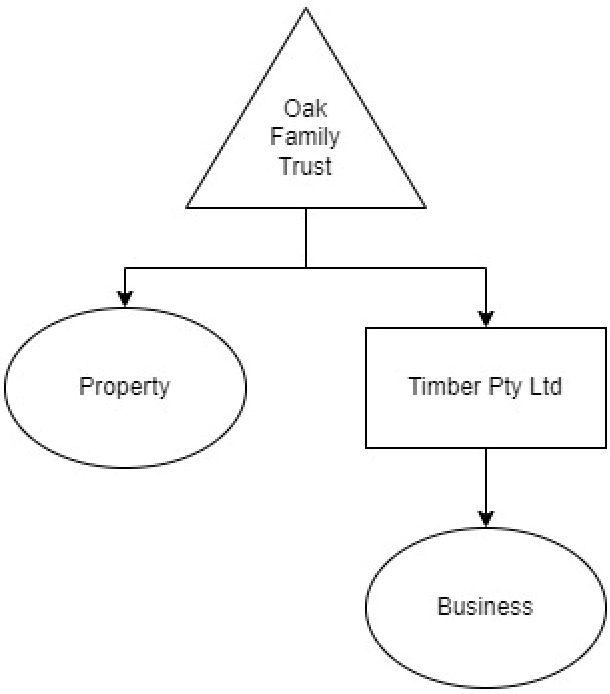
- SBRR: not taken to be a dividend for the purposes of Division 7A.
- Cost base in property remains at $5 million.
- Ability to split income going forward.
- If the property is sold in the future:
    a. the first $5 million comes out tax-free (due to cost base and no dividend issues due to no company);
    b. the general 50% CGT discount may apply to any capital gain.
- On the basis that the property is sold in the future for $9M:
    a. assuming proposed restructure: capital gain of $4M – general CGT discount – tax approx. $940,000
    b. assuming no restructure: capital gain of $4M – no general CGT discount – tax approx. $1.2M (30% corporate tax). Sum of $9M treated as a dividend. Approx $1.9M in further tax. Total tax: $3.1M.
- Duty: none as purchased under new Commercial and Industrial Property Tax Reform regime (no duty on subsequent transfers)

9.3 Case study 3 – Trust to Trust

9.3.1 Facts

- Arnold and Brian are brothers and jointly control the Oak Family Trust (Oak Pty Ltd as trustee for the Oak Family Trust).
- The trust was originally established by their parents.
- The Oak Family Trust owns a property and 100% of the shares in a company (Timber Pty Ltd). Timber Pty Ltd carries on a business (and has done so for around 14 years).
- The properties were previously used in the business (for around 10 years) and are now leased to unrelated parties. The property is worth $4.9 million and the shares in Timber Pty Ltd are worth $5.1 million.
- The turnover of the business is $8 million.
- Recent trust distributions have been 50/50 between Arnold and Brian.

Current Structure



9.3.2 Objectives

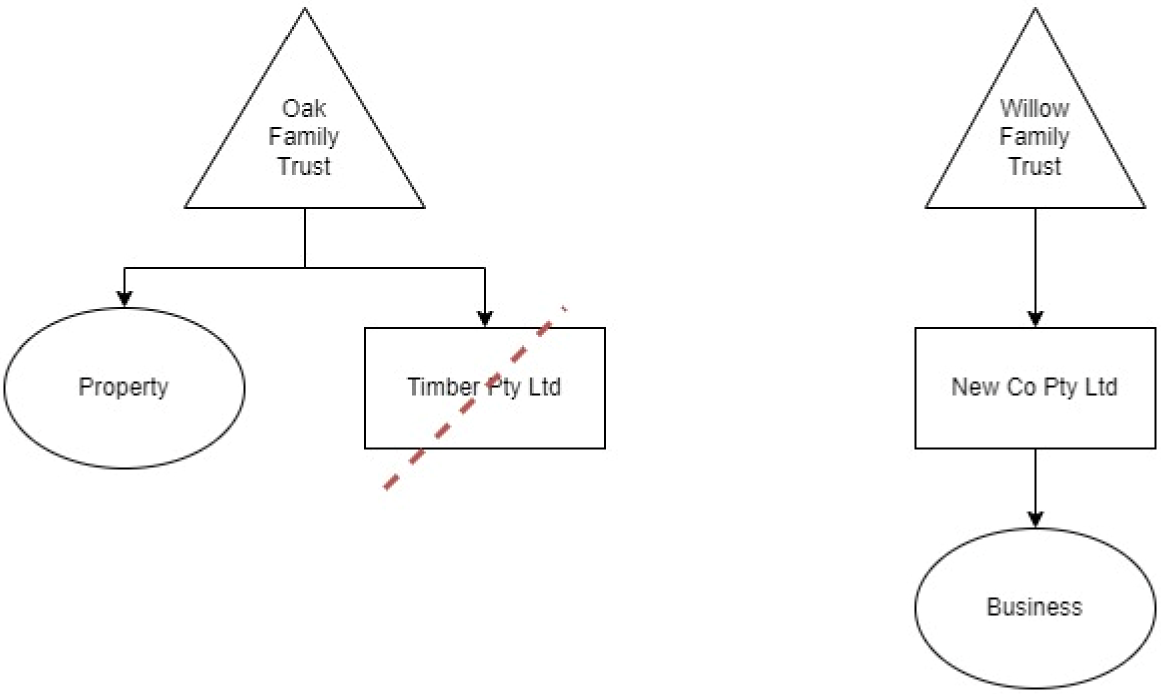
- Arnold and Brian want to separate the ownership of the trust assets, so that Arnold can control the property portfolio, while Brian can control and operate the Business.
- Brian hopes to sell the Business in 2-3 years' time.

9.3.3 Proposed Restructure

- The Willow Family Trust is established (new discretionary trust). Brian will be the sole Appointor.

- Timber Pty Ltd transfers its business to a newly incorporated company owned by the Willow Family Trust.
- Once the restructure occurs, the Willow Family Trust intends to distribute solely to Brian and Brian's immediate family.
- Once the restructure occurs, the Oak Family Trust intends to distribute solely to Arnold and Arnold's immediate family.

Proposed Restructure



9.3.4 Issues to Discuss

- Can the Concessions apply?
- Will the SBRR apply?
  a. Active Asset
  b. Genuine Restructure
  c. Ultimate Economic Ownership – is it necessary for both the Oak Family Trust and the Willow Family Trust to make an FTE?
- What are the tax consequences the Oak Family Trust were to sell the property in the future?
- If the Willow Family Trust were to sell the business in the future, could the Concessions apply? Is there a difference between a share sale and a business sale?

10.Reform

In December 2019, the then Minister for Housing and Assistant Treasurer, the Hon Michael Sukkar MP announced that the Board of Taxation (**Board**) would undertake a review of CGT roll-over rules.

The Board published its first consultation guide in February 2020 and a second consultation paper in December 2020. The Board of Taxation's website notes that *"The Board provided interim written advice to the Government on 25 March 2021 and will submit a final report by 22 April 2022."*

In general, the consultation papers sought feedback from stakeholders and industry experts on repealing various specific CGT rollovers (Subdivision 122-A, 122-B, 124-N, 126-B, 124-M and Division 125 and Division 615) and replacing them with the concept of a 'general business restructure rollover'.

A detailed discussion of the general business restructure rollover or its merits is beyond the scope of this paper. In relation to small businesses, the Board states that:

> *The Board considers that there is scope for significantly improving the co-ordination between the various CGT concessions available to small businesses. The current rules, while arguably creating flexibility for small business owners, also greatly increase the complexity and compliance cost involved in design and executing a restructure.*

The Board suggests that a more coherent model could involve:

- limiting the small business CGT concessions to arm's length disposals and replacements of assets;
- making the SBRR as an exclusive code for business restructures by small business entities; and
- making the general business restructure roll-over available to only those entities that are ineligible for the SBRR (i.e. above $10 million aggregated turnover).

Until such time as that occurs (*if that ever occurs*), small businesses remain in their unique position of having more tools available to reduce, eliminate or rollover the tax liabilities that would otherwise arise from a business restructure.

As this paper serves to illustrate, both the SBRR and the Concessions have their roles to play in business restructuring – each with enormous benefits and enormous minefields!