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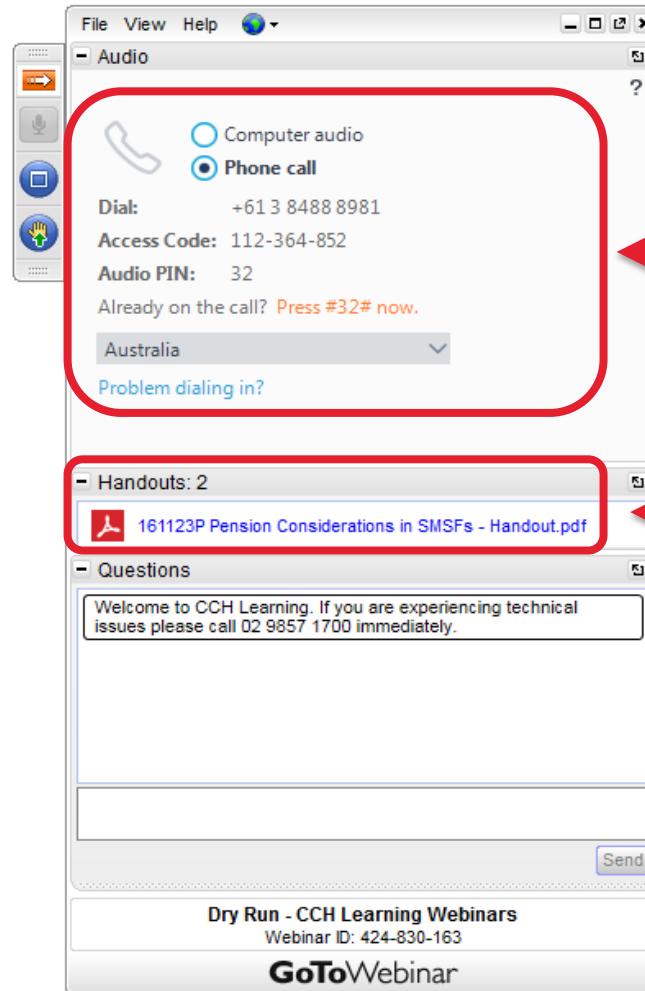
# Applying CGT Small Business Relief: A Practical Guide

Carlo Di Loreto

Tuesday 12 November 2024



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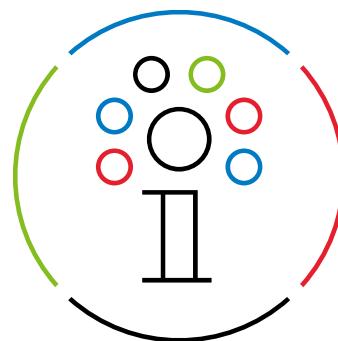
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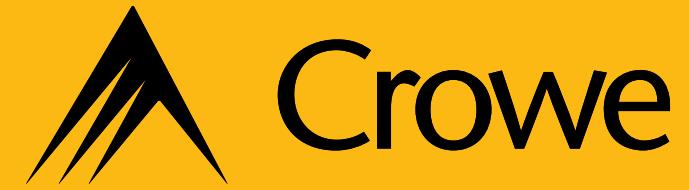
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# Today's session will cover



We will cover the practicalities of *applying* the following concessions:

- 15-year exemption [Subdivision 152-B]
- 50% reduction [Subdivision 152-C]
- retirement exemption [Subdivision 152-D]
- small business rollover [Subdivision 152-E]



# Reminder | Basic Conditions

# CGT Small Business Relief: Reminder

- CGT small business relief [Division 152 ITAA 1997] provides for a capital gain arising on certain assets to be reduced
- a number of 'basic conditions' [s 152-10] must be satisfied to access the reliefs & must be looked at separately for:
  - CGT events where asset is not a share or trust interest
  - CGT events where asset is a share or trust interest
  - CGT event D1 [creation of contractual or other rights]



# CGT Small Business Relief: Reminder of basic conditions

- 2 basic conditions must be satisfied [s 152-10]
- the first basic condition is that at least one of the following applies:
  - you are a 'small business entity' (SBE) for the income year [Subdivision 328-C]; or
  - you satisfy the net asset value test (NAVT) [s 152-15]; or
  - you are a partner in a partnership that is a SBE for income year & CGT asset is partnership asset

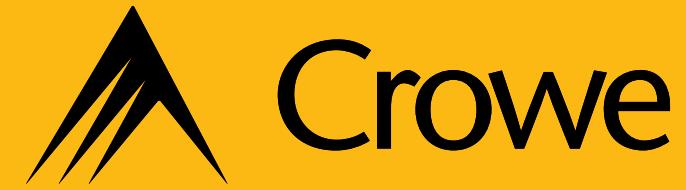


# CGT Small Business Relief: Reminder of additional basic conditions

- If CGT asset is a share in a company, or interest in a trust, you must satisfy either of following additional conditions [s 152-10(2)]:
  - the object entity may need to satisfy the NAVT or be a CGT SBE [s 152-10(2)(c)]
  - you are a CGT concession stakeholder in company or trust (i.e. you must be an individual); or
  - CGT concession stakeholders in company or trust have a combined small business participation percentage (SBPP) in you (i.e. the shareholder/unit holder) of at least 90%
  - ‘CGT concession stakeholder’ is a ‘significant individual’

Generally, a ‘significant individual’ is a person who holds at least a 20% interest in the company or unit trust.





# Applying the concessions: 15 year exemption

# CGT Small Business Relief: 15 year exemption

- CGT 15 year exemption can apply to gain made by an individual, company or trust
- if exemption applies - any capital gain disregarded & other CGT small business concessions irrelevant
- for trusts & companies - income from CGT event also disregarded
- distributions by a company or a trust directly or indirectly (up to exempt amount) - tax-free to recipient(s) in certain circumstances



# CGT Small Business Relief: 15 year exemption

- unless individual permanently incapacitated - 15 year exemption claimed for a CGT event that happens in connection with relevant individual's retirement
- if LPR of deceased person claiming relief – different rules apply where CGT event happens within 2 years of death
- CGT 15 year exemption does not affect individual's retirement exemption limit
- operates by disregarding capital gain – capital losses not absorbed



# CGT Small Business Relief: 15 year exemption

## Note:

- A non-concessional contribution by an individual to a complying superannuation fund is excluded from non-concessional contributions cap –
  - if made in relation to capital gain to which 15 year exemption (or retirement exemption) applies to the extent it does not exceed CGT cap amount.
- A choice must be made (s 292-100 ITAA 1997) & the CGT cap amounts are:
  - 2022 - 23            \$1,650,000
  - 2023 - 24            \$1,705,000
  - 2024 - 25            \$1,780,000



# CGT Small Business Relief: 15 year exemption Conditions for individuals

Individual taxpayer [s 152-105] can *disregard* a capital gain arising from a CGT event happening in relation to a CGT asset if:

- basic conditions met for CGT small business concessions to apply
- continuously owned CGT asset for 15 year period ending just before CGT event
- is 55 years of age or over at time of CGT event; and
- CGT event happens in connection with the taxpayer's retirement

## Note:

- Further conditions have to be met if CGT asset is a share / unit in unit trust
- If permanently incapacitated at time of CGT event - age & retirement conditions do not apply.



# CGT Small Business Relief: 15 year exemption Conditions for individuals – shares & units

- If CGT asset is a share in a company or an interest in a trust - conditions for 15 year exemption [s 152-110]:
  - the basic conditions for the 15 year exemption; and
  - the company or trust must have had:
    - a significant individual for a total of at least 15 years
    - during period individual taxpayer owned shares or interests

## Note:

- Does not have to be same significant individual
- 15 year period does not have to be continuous



# CGT Small Business Relief: 15 year exemption Retirement

- for CGT 15 year exemption to apply - CGT event must happen ‘in connection with’ the ‘retirement’ of individual [s 152-105(d)(i)] or significant individual [s 152-110(d)(i)]
- ATO view is that whether CGT event happens in connection with individual’s retirement depends on the circumstances case-by-case:
  - to be regarded as a retirement – needs to be significant reduction in number of hours individual works; or
  - significant change in nature of their present activities
- not necessary for there to be a permanent & everlasting retirement from workforce
- ATO accept *‘in connection with’* can apply where CGT event occurs some time before and/or some time after retirement

Examples of how to apply the 15-year exemption are set-out at the end of this webinar.



# CGT Small Business Relief: 15 year exemption Permanent Incapacity

- if an individual taxpayer or significant individual permanently incapacitated at time of CGT event
  - no age or retirement requirement
- ‘permanently incapacitated’ not defined – ordinary meaning applies & ultimately depends on individual circumstances
- ATO take the view that indicative description of term is ill health (whether physical or mental), where it is reasonable to consider that the person is
  - unlikely because of ill health
  - to engage again in gainful employment for which they are qualified
- ATO acknowledge incapacity does not necessarily need to be permanent in sense of everlasting



# CGT Small Business Relief: 15 year exemption

## Companies & trusts

- The concessions for individuals & significant individuals to access the 15 year exemption can apply if:
  - a capital gain of a company or trust is disregarded [s 152-110];
  - an amount of income is treated as non-assessable non-exempt income of a company or trust [s 152-110]; or
  - the capital gain would have been disregarded because the CGT asset was acquired pre-CGT



# CGT Small Business Relief: 15 year exemption

## Conditions for companies & trusts

- A company or trust can disregard a capital gain that arises from a CGT event in connection with a CGT asset of a company or trust [s 152-110] if:
  - basic conditions are met for CGT small business concessions apply to gain
  - company or trust continuously owned CGT asset for 15-year period ending just before CGT event
  - company or trust had significant individual for total of at least 15 years during time when company or trust owned CGT asset
  - individual who was a significant individual of a company or trust just before CGT event was 55 years of age or over & event happened in connection with individual's retirement

# CGT Small Business Relief: 15 year exemption

## Companies & trusts

- If 15 year exemption applies to a company or trust [s 152-110(2)]:
  - a capital gain of company or trust disregarded; and/or
  - an amount of ordinary income or statutory income of the company or trust is neither assessable income / exempt income
- Rules allow these benefits to be accessed by an individual who was a CGT concession stakeholder of company or trust just before CGT event

### Note:

- The ‘significant individual’ rules mean that a company or trust can have up to eight CGT concession stakeholders (4 significant individuals & their spouses) that can potentially access the relief.

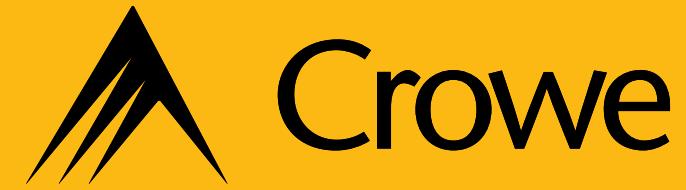


# CGT Small Business Relief: 15 year exemption

## Companies & trusts

- The concessions for individuals & significant individuals to access the 15 year exemption can apply where [s 152-125]:
  - company or trust makes one or more payments (whether directly or indirectly through one or more interposed entities)
  - in relation to an ‘exempt amount’
  - within 2 years (or a longer period allowed by the Commissioner) after relevant CGT event
  - to an individual who was a CGT concession stakeholder of the company or trust just before the event





**Applying the  
concessions:  
50% reduction**

# CGT Small Business Relief: 50% reduction

- If basic conditions for CGT small business concessions [s 152-205] & 15 year exemption does not apply [s 152-215]:
  - capital gain reduced by 50% under small business reduction (unless choice made not to apply [s 152-220]); and
  - capital gain reduced by 50% reduction (or capital gain if choice made not to apply) can qualify for [s 152-210]:
    - CGT small business retirement exemption; or
    - small business roll-over relief; or
    - partly for one or other concession
  - 50% reduction can be claimed by all types of entities (individuals, trusts & companies)



# CGT Small Business Relief: 50% Reduction

- if capital gain that qualifies for 50% reduction made by individual or trust & capital gain is discount capital gain - CGT discount applied first [s 152-205]
- prior to concessions (other than 15 year exemption) being applied – capital loss of current income year & carried forward losses offset
- choice can be made on order in which capital losses applied to maximise benefit of the CGT concessions - even if 50% reduction available – open to choice not to apply
- choice applies in relation to full amount of capital gain that qualifies for 50% reduction – can not be claimed in part

## Note:

The choice not to apply the 50% reduction must be made by the day on which the taxpayer lodges their income tax return for the income year in which CGT event occurred (or within a further period of time allowed by the Commissioner) [s 103-25].



# CGT Small Business Relief: 50% Reduction

## Note:

- The choice not to apply the 50% reduction must be made by the day on which the taxpayer lodges their income tax return for the income year in which CGT event occurred (or within a further period of time allowed by the Commissioner) [s 103-25]

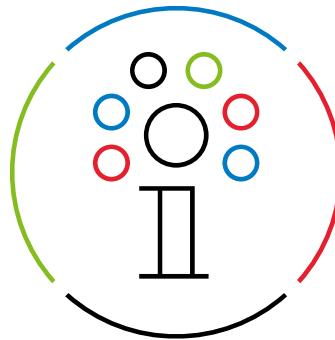
An example of how apply the 50% reduction is set-out at the end of this webinar.

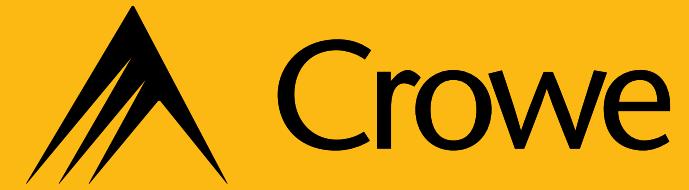


# Poll Question #1

The 15 Year Exemption must be paid into a complying superannuation fund.

- a) True
- b) False





# Applying the concessions: Retirement exemption

# CGT Small Business Relief: Retirement exemption

- If basic conditions for CGT small business relief satisfied in relation to capital gain:  
*and*
  - 15 year exemption does not apply;  
*and*
    - capital gain exists after applying 50% reduction, then may be eligible for:
      - retirement exemption or
      - CGT small business roll-over relief



# CGT Small Business Relief: Retirement exemption

- taxpayer can choose not to apply 50% reduction [s 152-220]
- making of choice not to apply – can mean retirement exemption or roll-over relief available for whole of capital gain that qualifies for relief
- where roll-over relief chosen - capital gain from J2, J5 or J6 events do not qualify for 50% reduction but:
  - may be possible to claim retirement exemption or roll-over for J2 event
  - if gain qualifies for both retirement exemption & roll-over relief – can choose ordering



# CGT Small Business Relief: Retirement exemption

- where company or trust claiming retirement exemption – company or trust must make payment to one or more CGT concession stakeholders [s 152-325]
- payment can be made up to but not exceeding CGT concession stakeholder's retirement exemption limit
- if CGT concession stakeholder < 55 years of age - payment must be made by contributing to complying superannuation fund or RSA
- once choice made in respect of capital gain for retirement exemption / roll-over relief to apply – can not be altered



# CGT Small Business Relief: Retirement exemption

- amount of capital gain for which retirement relief can be chosen depends on how other reliefs applied - capital gain chosen for retirement exemption called asset's '*CGT-exempt amount*'
- choice must be made in such a way that individual's CGT retirement exemption limit not exceeded [s 152-315(2)(a)]
- if < 55 years of age just before choice made - an amount equal to asset's CGT-exempt amount has to be contributed to a complying superannuation fund or an RSA [s 152-305(l)(b)]



# CGT Small Business Relief: Retirement exemption

- no requirement for individual to retire or terminate any activity that he or she is carrying on
- if individual at least 55 years just before choice made for retirement relief – payment can be made to individual directly
- timing of the making choice for retirement relief governed by general CGT choice-making rules [s 103-25 ITAA97]

## Note:

- the amount chosen by an individual for retirement exemption must not exceed asset's CGT exempt amount
- must be specified in writing [s 152-315(3) & (4)]



# CGT Small Business Relief: Retirement exemption

- an individual's CGT retirement exemption limit is \$500,000 - reduced by CGT-exempt amounts of CGT assets specified in choices previously made [s 152-320]
- if individual makes choice for retirement exemption to apply for any part of a capital gain - that part of capital gain = CGT exempt amount disregarded
- if taxpayer < 55 years of age just before the choice for retirement relief is made
  - must contribute amount (equal to the asset's CGT-exempt amount)
  - to a complying superannuation fund or an RSA
- amounts contributed to comply with this rule not allowable deductions



# CGT Small Business Relief: Retirement exemption

- contribution to complying superannuation fund or RSA by individual < 55 years of age has to be made at later of [s 152-305(1)(c)]:
  - when individual makes the choice for retirement relief; and
  - when individual receives the proceeds
- where CGT event J2, J5 or J6 - contribution has to be made when choice made



# CGT Small Business Relief: Retirement exemption

- Under retirement exemption [s 152-325] - company or trust can choose to disregard all or part of capital gain provided:
  - basic conditions satisfied for the gain
  - company or trust satisfies significant individual test
  - other conditions for company or trust satisfied

## Note:

- When capital gain results from CGT event J5 or J6 being triggered - basic conditions for CGT small business concessions do not need to be satisfied.

# CGT Small Business Relief: Retirement exemption

- company or trust must make payments (directly or indirectly) CGT concession stakeholders in line with stakeholder percentages
- if choice relates CGT event (other than J events) - payment must be made by later of [s 152-325(4)]:
  - 7 days after company or trust makes choice; and
  - 7 days after company or trust receives amount of capital proceeds from event
- if retirement exemption relates J2, J5 or J6 event - payment to be made with 7 days of company or trust making choice

## Note:

- The Commissioner does not have a discretion to extend period – for payment to be made by particular date – needs to be made on or before that date.

# CGT Small Business Relief: Retirement exemption

- if company or trust receives capital proceeds by way of instalments - payment requirements apply to each instalment in succession [s 152-325(2)]
- means that total amount of each instalment must be paid in relation to each CGT concession stakeholder until total payments = capital gain disregarded
- requirement to make payment must be satisfied to greatest extent possible out of initial instalments
- can not be made in some other way

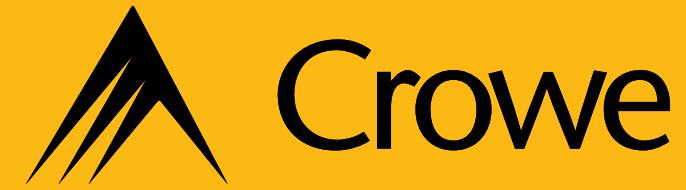


# CGT Small Business Relief: Retirement exemption

- if CGT concession stakeholder < 55 year just before payment made [s 152-325(7)]:
  - company or trust must make payment to CGT concession stakeholder by contributing it for stakeholder to complying superannuation fund or RSA; and
  - company or trust must notify trustee of the fund or the RSA at the time contribution made that contribution made in accordance with s 152-325 ITAA97
- where CGT concession stakeholder 55 or over just before payment:
  - payment can be made directly to concession stakeholder
  - not assessable income & not exempt income

Examples of how to apply the retirement exemption are set-out at the end of this webinar.





# Applying the concessions: Roll-over relief

# CGT Small Business Relief: Roll-over relief

- if capital gain qualifies small business relief & 15 year exemption does not apply - capital gain not disregarded by 50% reduction - may be eligible for [s 152-400]:
  - retirement exemption; or
  - roll-over relief
- you can choose not to apply 50% reduction – making choice means retirement exemption or roll-over may be available for whole amount of gain
- if gain (or part of gain) qualifies for retirement exemption & roll-over - you can choose order in which to apply



# CGT Small Business Relief: Roll-over relief

- The roll-over relief can be chosen for whole or part of gain that qualifies for relief – being amount not disregarded or reduced under CGT discount & other small business reliefs
- The choice means amount of gain chosen is disregarded
- If at end of replacement asset period – no replacement asset - CGT event J5 triggered
- If replacement asset period ends & part of capital gain rolled over [s 152-410]:
  - not represented by relevant replacement asset; or
  - fourth element expenditure
- CGT event J6 triggered - gain equal to that part made
- to extent gain rolled over not remade by CGT event J5 or J6 – triggered by CGT event J2 if & when relevant replacement asset ceases to be active asset



# CGT Small Business Relief: Roll-over relief

- if basic conditions met & 15 year exemption does not apply – you can choose roll-over relief for gain
- if you choose roll-over relief – you can choose to disregard all or part of capital gain for which relief chosen [s 152-415]
- amount of gain for which roll-over available depends on how you have applied other concessions
- possible that for some gains - roll-over relief may be the only available relief



# CGT Small Business Relief: Roll-over relief

- you can choose roll-over relief even if you have not yet acquired replacement asset or incurred 4th element expenditure [s 152-410]
- can also choose even if you does not anticipate acquiring replacement asset or 4th element expenditure
- making of a choice of roll-over relief & whether all or part of capital disregarded – subject to general CGT choice-making rules [s 103-25]

## Note:

- CGT events J5, J6 & J2 may apply at end of replacement asset period in certain circumstances



# CGT Small Business Relief: Roll-over relief

- CGT event J5 [s 104-197]- if either:
  - no replacement asset has been acquired (& no relevant expenditure incurred) before end of replacement asset period, or
  - any replacement asset not active asset at end of period
- CGT event J6 [s 104-198] - if whole of capital gain for which roll-over relief chosen not utilised by end of replacement asset period
- CGT event J2 [s 104-185] - if at end of replacement asset period - status of asset changes in a defined way
- a capital gain that arises from CGT event J2, J5 or J6:
  - cannot qualify for 50% CGT general discount, the CGT 15-year exemption or 50% reduction;
  - can qualify for retirement exemption or for J2 events - roll-over relief



# CGT Small Business Relief: Roll-over relief

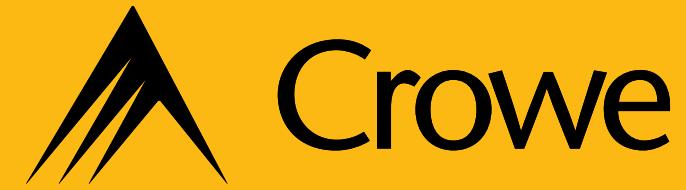
- replacement asset period - period within which replacement asset must be acquired or 4th element expenditure must be incurred [s 104-185]
- starts 1 year before & 2 years after last CGT event in income year for which roll-over accessed
- vital to ensure exact date of CGT event known to accurately determine replacement asset period
- Commissioner has discretion to extend replacement asset period [s 104-190(2)]



# CGT Small Business Relief: Roll-over relief

- can use roll-over relief if you incur (during replacement asset period) 4th element expenditure in relation to CGT asset (must be an active asset at end of replacement asset period)
- you incur 4th element expenditure in relation to CGT asset if you incur capital expenditure included in 4th element of asset's cost base, which is capital expenditure:
  - the purpose or expected effect of which is to increase or preserve the asset's value; or
  - that relates to installing or moving the asset, but does not include expenditure incurred in relation to goodwill
- a replacement asset - providing it is an active asset at end of replacement asset period – any kind of CGT asset

Examples of how to apply the roll-over relief and CGT 'J' events are set-out at the end of this webinar.



# Order to apply Small Business CGT Concessions

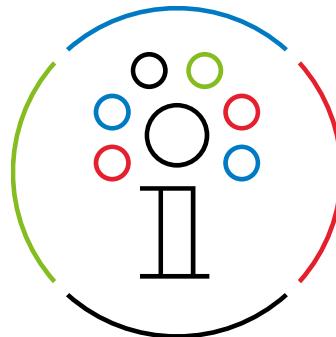
# CGT Small Business Relief: Order of application

Steps	Calculation	Note
1	15 Year Exemption	Capital gain entirely disregarded Applies before capital losses and discount
2	Capital Losses	Reduces capital gain
3	CGT General Discount	See Division 115 ITAA 1997
4	50% Reduction	Optional
5	Retirement Exemption	Can be applied or omitted for rollover
6	Small Business Rollover	Rollover is a deferral only
7	Net Capital Gain	Remaining gain after the above steps

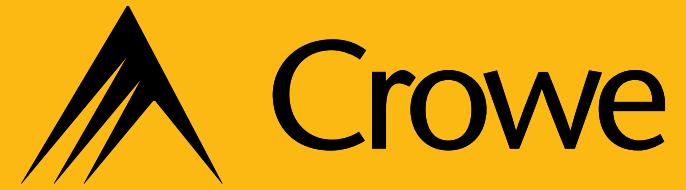


# Poll Question #2

Which of the following is a J2 event in relation to a replacement asset rollover?



- a) The asset stops being active
- b) No asset is purchased
- c) Your expenditure on the asset is not sufficient
- d) All of the above
- e) None of the above



# Partnerships

# CGT Small Business Relief: Partnerships

## Basic conditions

- When CGT asset used in (or held ready for use in or is inherently connected with) a business carried on by a partnership - small business CGT concessions [s 152-10(1)(c) & (d)] need to be considered in different situations where asset is:
  - a partnership asset;
  - owned by a partner and is not a partnership asset; and
  - owned by an entity that is not a partner.



# CGT Small Business Relief: Partnerships

## Partnership asset

- partner in general law partnership carries on business by being partner in partnership
- where CGT asset is partnership asset - each partner may qualify for small business CGT concessions
- for CGT small business relief basic conditions to be met:
  - partner must satisfy maximum net asset value test; or
  - small business entity test must be met; and
  - CGT asset of partner must meet active asset test.



# CGT Small Business Relief: Partnerships Owned by partnership

- Where CGT asset owned by partner is used in (or is held ready for use in or is inherently connected with) partnership business – concessions may also apply provided:
  - partner satisfies maximum net asset value test; or
  - small business entity test met; and
  - CGT asset of partner meets active asset test



# CGT Small Business Relief: Partnerships Owned by other entity

- Where CGT asset owned by entity that is not partner & is used in business carried on by partnership – small business CGT concession may also be available:
  - either:*
    - partner in partnership must be *affiliate* of, or be *connected with*, entity that owns CGT asset; or
    - partnership must be connected with* entity that owns CGT asset;
  - either:*
    - entity that owns CGT asset must satisfy maximum net asset value test ; or
    - small business entity test must be met; and
    - CGT asset must meet the active asset test.

# CGT Small Business Relief: Partnerships

## Active assets

- If entity owns CGT asset in (or is held ready for use in or is inherently connected with) business carried on by a partnership - asset is active asset if:
  - entity that owns the CGT asset is a partner in the partnership;
  - a partner in the partnership is an affiliate of entity that owns CGT asset;
  - the entity that owns CGT asset & the partnership are connected entities; or
  - the entity that owns CGT asset & a partner are connected entities



# CGT Small Business Relief: Partnerships Affiliate

- An individual or company is an affiliate [s 328-130(i)] of an entity where that individual or company acts, or could reasonably be expected to act:
  - in accordance with the entity's directions or wishes in relation to the affairs of that individual or company's business, or
  - in concert with the entity in relation to the affairs of the individual or company's business



# CGT Small Business Relief: Partnerships Affiliate

## Note:

- Only an individual or company can be affiliate of another entity - entities like trusts, partnerships & superannuation funds are not capable of being affiliates of an entity.
- An individual or a company is not an entity's affiliate simply because of the nature of the business relationship shared by entity & the individual or company [s 328-130(2)].
- A partner is not necessarily an affiliate of another partner merely because the first partner acts, or could reasonably be expected to act, in accordance with the directions or wishes of the second partner, or in concert with the second partner, in relation to the affairs of the partnership.



# CGT Small Business Relief: Partnerships

## Connected entity & control

### Connected Entity

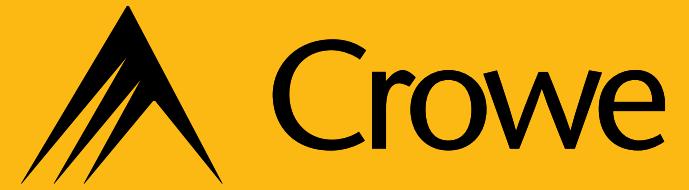
- An entity is ‘connected with’ another entity [s 328-125] if:
  - either entity controls the other entity, or
  - both entities are controlled by the same third entity.

### Control

- You control a partnership [s 328-125(2)] if:
  - you and/or your affiliates
  - have a right to 40% or more of the partnership’s net income or capital

Examples of how SBR applies to partnerships are set-out at the end of this webinar.





# Death

# CGT Small Business Relief: Death

- death of individual does not give rise to a capital gain or capital loss
- the LPR of deceased & beneficiaries of estate take over CGT assets of deceased
- at date of death - appropriate cost base & reduced cost base ascribed to assets
- special rules exist for CGT main residence exemption



# CGT Small Business Relief: Death

- disposal of CGT asset (owned by deceased at date of death) by LPR or beneficiary of estate
- may qualify for the CGT small business relief
- if disposal occurs within two years of the death [s 152-80]
- applies regardless of whether LPR or beneficiary has used asset in relevant business



# CGT Small Business Relief: Death

- asset forms part of estate of deceased individual or was owned by joint tenants, one of whom has died & one of the following applies:
  - asset devolved to LPR of deceased or to trustee of a testamentary trust established by will of deceased
  - asset passes to a beneficiary in estate of deceased individual
  - an interest in CGT asset acquired by surviving joint tenant
- deceased individual or deceased joint tenant would have been entitled to reduce / disregard capital gain under CGT small business concessions if CGT event had happened in relation to CGT asset immediately before death; and
- CGT event triggered for CGT asset within 2 years of deceased individual's or the deceased joint tenant's death



# CGT Small Business Relief: Death

- where conditions met for CGT event within 2 years of death, then:
  - the LPR
  - the beneficiary to whom the asset passes;
  - the trustee of the testamentary trust or a beneficiary of that trust; or
  - the surviving joint tenant
- entitled to reduce or disregard a capital gain under small business CGT concessions in the same way as the individual would have been entitled to [s 152-80(2A)]

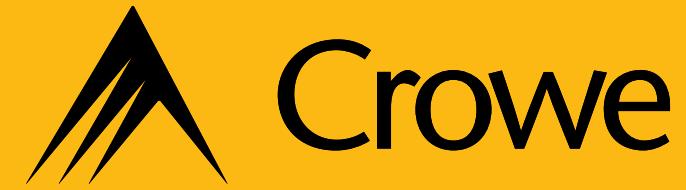


# CGT Small Business Relief: Death

- Key assumptions under the 2 year rule are that:
  - *when applying 15 year exemption* - deceased individual need only be 55 years of age or over, or be permanently incapacitated, immediately before his or her death
  - *when applying retirement exemption* - requirement for individuals under 55 years of age to contribute CGT exempt amount to complying superannuation fund or an RSA ignored
  - if conditions met for CGT event within 2 years of death - all of small business CGT concessions may be available to LPR, trustee, beneficiary or surviving joint tenant
  - concessions available in the same way as deceased would have been entitled to claim them
  - rule can only apply if the deceased individual or their joint tenant would have qualified for concessions – if CGT event had happened in relation to CGT asset immediately before death

An example of how SBR is applies on death is set-out at the end of this webinar.





# **Look Through Earnout Rights (LTER)**

# LTER and CGT Small Business Relief

- An earnout arrangement is a contractual arrangement in respect of the sale of a business
- The seller and buyer agree for future financial benefits for a specified period after the sale that is contingent on the performance of the business
- When financial benefits are received under the LTER – taxed in accordance with subdiv 118-I ITAA 1997
  - Capital gain or loss arising on the creation of the LTER is disregarded
  - Proceeds provided by the buyer under the LTER form part of the cost base of the CGT assets acquired
  - Proceeds the seller receives under the LTER increase the capital proceeds for the CGT assets disposed
- Seller must amend tax return for the year the sale of the business occurred
- Benefits may be received for up to 5 years from the year the sale takes place

# LTER and CGT Small Business Relief

## Active Asset Test – Shares or Interests in trusts

- Alternative test applies under the LTER rules where a share in a company or interest in a trust is sold
  - avoids the need to value the underlying entity for the purposes of determining the 80% requirement
- Taxpayer can look at how the entity has earned its income over the previous year
- Share in a company or interest in a trust is an active asset under LTER if:
  - At least 80% of the assessable income for the most recent year was from carrying on a business and was not derived as passive income from interest, annuities, rent, royalties or forex gains
  - CGT concession stakeholder requirements must be satisfied
  - Company or trust must carry on a business since start of most recent income year
  - Company or trust cannot be part of Tax Consolidated Group



# LTER and CGT Small Business Relief

## NAVt and CGT SBE

- Option exists whether to include *market value of LTER in NAVt* or, instead include *value of the financial benefits actually received*

## Retirement Exemption

- Adjusted for amounts received under LTER (each separate amount received) up to the CGT exempt amount

## 15 Year Exemption

- 2 year limit is extended for company or trust to make payments to CGT concession stakeholders

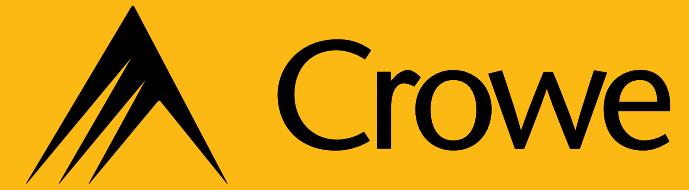
## Small Business Rollover

- 2 year period to acquire active asset extended to 6 months after expiration of financial benefits received in respect of LTER

# Earnouts that are not LTER

- If the earnout *does not qualify* as a LTER – TR 2007/D10(W) sets out former ATO view
- Earnout arrangements that are NOT LTER are not active assets and do not qualify for relief
- Under a standard earnout the following implications arise:
  - Seller entitled to receive further payments based on performance conditions
  - Earnout rights are considered a CGT asset
  - The market value of the earnout rights received by the seller are part of the capital proceeds for the sale of the business – also forms cost base of the earnout rights to the seller
  - CGT event C2 occurs when payments are received by the seller under the earnout rights
- Reverse earnout rights involve the buyer being entitled to receive payments from the seller based on performance of the underlying business
  - Reduces the capital proceeds of the seller from sale of business





# Worked Examples

# CGT Small Business Relief: 15 year exemption

## Example

- Ella & Sandie are partners in a partnership that conducts a market garden business on land they purchased in 2000 and have owned continuously since that time.
- The net value of their CGT assets for the purpose of the maximum net asset value test is less than \$6 million.
- Ella & Sandie are both over 60 years old and wish to retire. They have no children & they decide to sell the major asset of the market garden business, the land.
- They sell the land in December 2021 for a total capital gain of \$2 million.
- Both Ella & Sandie qualify for the small business 15-year exemption, in relation to the capital gain.



# CGT Small Business Relief: 15 year exemption Permanent Incapacity - Example

- Jess had been carrying on a business for many years. Unfortunately, she developed severe health problems, and her health continued to deteriorate to the point where she was incapable of operating the business and, as a result, she sold the business.
- At the time when the business was sold, her doctor provided a written statement that Jess suffered from ill health to the extent that she was unlikely to be able to engage again in gainful employment for which she was reasonably qualified. Jess was under 55 years of age when she sold the business.
- Having regard to all of the circumstances, Jess would be considered to be permanently incapacitated at the time when the business was sold. She may therefore qualify for the CGT 15-year small business exemption if she satisfies the other conditions.

# CGT Small Business Relief: 15 year exemption Companies & trusts - Example

- The beneficiaries of the Tan family discretionary trust are:
  - the members of the Tan family; and
  - two employees of the family business carried on by the trustee of the trust.
- Mrs. Tan & Mr. Tan & their 3 children are significant individuals of the discretionary trust & are therefore CGT concession stakeholders.
- The trustee of the trust sells a CGT asset of the business & makes a capital gain of \$500,000.



# CGT Small Business Relief: 15 year exemption Companies & trusts - Example

- The gain qualifies for 15 year exemption because Mr. Tan is 58 years old & plans to retire from the family business.
- In the next income year the trustee distributes that amount equally to Mrs. Tan, Mr. Tan & their three children.
- The CGT concession stakeholders, Mrs. Tan, Mr. Tan & their three children are each able to treat the distribution of \$100,000 as an exempt amount.



# CGT Small Business Relief: 50% Reduction Example

- Preeda is a sole practitioner commercial lawyer. In January 2021, she sells her business premises which she has owned for over 10 years.
- The sale of the business premises generates a capital gain of \$250,000.
- Preeda satisfies the small business CGT concessions basic conditions. She has carried forward capital losses from prior years of \$30,000.
- How does she calculate her net capital gain?



# CGT Small Business Relief: 50% Reduction Example

## Note:

- The net capital gain of \$55,000 can be further reduced by the retirement exemption or the rollover relief if Preeda can satisfy the relevant conditions.

Capital gain	\$250,000
<i>Less: Prior year capital losses</i>	(30,000)
	220,000
<i>Less: 50% CGT discount</i>	(110,000)
	110,000
<i>Less: 50% reduction</i>	(55,000)
Net capital gain	55,000

# CGT Small Business Relief: Retirement exemption Example

- In January 2021, Quan retires from farming & transfers the farm, which he acquired in 2010, to his daughter Lan for no consideration.
- The market value of the farm was \$2m so the market value substitution rule applies to deem the capital proceeds to equal the market value of the farm.
- The CGT cost base of the farm was \$800K, so Quan made a capital gain of \$1.2m. He reduces this by the 50% CGT discount to \$600K & then further by the 50% active asset reduction to \$300K.
- Even though no capital proceeds received, Quan can choose retirement exemption for full amount of the remaining \$300K capital gain (assuming other retirement exemption conditions are satisfied).



# CGT Small Business Relief: Retirement exemption Example

- Sione & his wife Laaka, each own 50% of the shares in a company & are both significant individuals of the company.
- The company makes a capital gain & specifies Sione's percentage of the exempt amount to be 90%.
- This means that the percentage specified for Laaka must be 10%. Sione's retirement exemption limit is \$500,000.
- To determine whether his exemption limit is exceeded, Sione would take 90% of the exempt amount, add that to amounts previously specified & see whether the total exceeds \$500,000.



# CGT Small Business Relief: Retirement exemption Example

- Željko & his wife Mirjana each own 50% of the shares in a company. They are both significant individuals of the company.
  - The company makes a capital gain & specifies Željko's percentage of the exempt amount to be 90%, which means that the percentage specified for Mirjana must be 10%.
  - Željko's retirement exemption limit is \$500,000.
  - To determine whether his exemption limit is exceeded, Željko would take 90% of the exempt amount, add that to amounts previously specified & see whether the total exceeds \$500,000.

# CGT Small Business Relief: Roll-over relief Example

- Monica owns 50% of Small Co Pty Ltd & 50% of the shares in Micro Co Pty Ltd. This makes her a CGT concession stakeholder in both companies. The companies are connected with Monica because she controls both of them.
- Small Co Pty Ltd owns land which it leases to Monica for use in a business. It sells the land at a profit & buys shares in Micro Co Pty Ltd as replacement assets. All of the assets of Micro Co Pty Ltd are active assets.
- The replacement asset test is satisfied because the shares are active assets & Monica is connected with Small Co Pty Ltd & is a CGT concession stakeholder in Micro Co Pty Ltd.

# CGT Small Business Relief: Roll-over relief

## Example: CGT event J5

- In September 2019, Katie makes a capital gain of \$150,000 on an active asset & meets the maximum net asset value test
- Katie disregards the whole capital gain under the small business rollover.
- In September 2021, Katie does not have any replacement or capital improved assets by the end of the two-year period
- CGT event J5 happens & she makes a capital gain of \$150,000 in September 2021



# CGT Small Business Relief: Roll-over relief

## Example: CGT event J6

- In October 2019, Talia makes a capital gain of \$700,000 on an active asset and meets the maximum net asset value test. Talia chooses to disregard the whole capital gain.
- In November 2020, Talia buys new business premises for \$300,000 and spends \$150,000 on improving some other assets. The replacement & capital improved assets meet all of the relevant conditions.
- The amount of expenditure on the replacement and capital improved assets is only \$450,000. The capital gain that was rolled over was \$700,000.
- In October 2021, two years after the original CGT event, CGT event J6 happens because there has been insufficient expenditure & Talia makes a capital gain of \$250,000. The rollover of \$450,000 of the original capital gain continues.



# CGT Small Business Relief: Roll-over relief

## Example: CGT event J2

- Charlie makes a capital gain of \$400,000 from the sale of his business premises. After applying the CGT discount & 50% reduction, the gain is \$100,000. He chooses to apply the small business relief roll-over to the remaining \$100,000.
- Within 2 years of selling the business premises, Charlie buys new premises for \$1.5 m. The new business premises are Charlie replacement asset. He sells the replacement asset 3 years later for \$1.8 million.
- The sale of the replacement asset triggers CGT event J2 & Charlie must include a \$100,000 capital gain in his ITR for the year. He has also made a \$300,000 gain on the sale of the business premises & after applying the CGT discount & 50% reduction, the gain is reduced to \$75,000.
- He can choose to apply the retirement exemption and / or roll-over relief to both capital gains for the year.



# CGT Small Business Relief: Partnerships

## Partnership asset - Example

- Mariette, Alessandra, Elena & Sofia operate a legal practice together in partnership. The partnership sells its business premises for \$8.5 million & makes a capital gain of \$4.0 million.
- Each partner's share of the \$4.0 million capital gain is \$1.0 million. The net value of the partnership's assets is \$12.0 million.
- Each partner owns a 25% share of the partnership assets, so they include this value when calculating the value of their own net assets.
- Provided each individual partner satisfies the MNAVT, they will be able to access the small business CGT concessions.



# CGT Small Business Relief: Partnerships Owned by other entity - Example

- Alicia & her 3 daughters are partners in a business that brews craft beers. She is the controlling partner, with a 50% interest in the partnership. The business is operated from premises owned by the Family Discretionary Trust (FDT).
- Under the FDT, Alicia & her family members are the primary beneficiaries. For the last three income years, Alicia has received 45% of all of the distributions made by the trustee.
- Alicia controls both the partnership & the FDT (under the control & pattern of distributions tests). This means that premises will qualify as an active asset of the FDT because the FDT and the partnership are connected entities.

# CGT Small Business Relief: Death Example

- Small Co Pty Ltd was incorporated in July 2017 & from that date, carried on a manufacturing business. The company is wholly owned by Lisa, who acquired the premises from where the company carried on business in May 2017.
- Small Co Pty Ltd sold the business in March 2019 to a third party purchaser & Lisa leased the premises to the new business owner. Lisa died in February 2021 & the business premises is sold by the executor in November 2021.
- The premises would have met the active asset test just before Lisa's death, because they were an active asset > half of the time from their acquisition until her death.
- Provided Lisa meets the SBE / MNAVT immediately before her death, then the 2 year rule will apply.

# Questions?



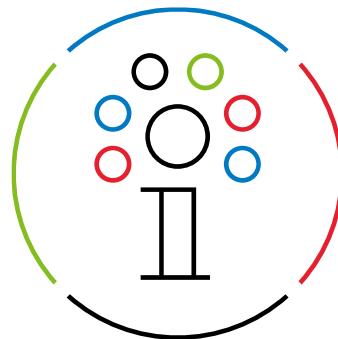
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- 14 November - Financial and Sustainability Reporting Update - Getting Ready for 31 December 2024 Reporting Season
- 19 November – Empowering Professional Parents – Balancing Work, Life and Family
- 20 November – Ethical Traps – Promoting the Firm and Yourself



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# Questions?



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Or contact me via:

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