

The Tax Summit

Session 13.1: The cutting edge of small business CGT concessions – Planning and traps

Presented at International Convention Centre Sydney (ICC) 11–13 September 2024

Joshua Pascale, ATI
Cowell Clarke

Contents

1. Overview	3
2. Creating Ties to Non-Trading Entities.....	4
2.1 Connected with Test.....	4
2.2 Affiliate Test.....	6
3. Aggregated Turnover Test (Small Business Entity Test)	8
4. Maximum Net Asset Value Test.....	10
5. Active Asset Test.....	12
5.1 Utilising Trust Nominations.....	12
5.2 Active Asset Turned Passive.....	12
6. Classes of Shares: Significant Individual Test.....	14
7. Buying Time with the Replacement Asset Roll-Over	15
8. 15-Year Exemption: Retirement in Connection with CGT Event	17
9. Making CGT Exempt Payments without Sale Proceeds	19
10. Using SBCC in Conjunction with SBRR	20
11. Concluding Remarks.....	22

1. Overview

The Small Business Capital Gains Tax Concessions (“**SBCC**”) are often at the forefront of many advisers’ minds when considering the sale or restructure of an SME.

Owing to the favourable outcomes that the SBCC can achieve, advisers are highly familiar with the general concepts and criteria and can often recite the conditions to their clients verbatim. This paper does not consider the general criteria and application of the SBCC.

Rather, this paper seeks to explore a number of challenging issues and planning tips that may arise in a sophisticated application of the SBCC. This paper is based on the author’s experience in advising on the SBCC, and it begins by raising some of the difficulties in applying the “connected with” and “affiliate” concepts to entities that own CGT assets but do not trade.

All statutory references in this paper are to the *Income Tax Assessment Act 1997* (Cth) unless otherwise stated.

2. Creating Ties to Non-Trading Entities

Clients are often well-advised to house valuable CGT assets in structures that are separated from trading activities (usually but not always discretionary trusts). This is to provide a level of protection over those assets in the event that a claim is brought against the trading entity.

These typical arrangements can sometimes lead to difficulties in accessing the SBCC on the eventual realisation of the asset (whether by way of sale or internal restructure). In particular, there can be issues in creating the necessary ties between the trading entity and the non-trading entity for the purposes of the \$2 million small business entity test and the active asset test.

2.1 Connected with Test

This section considers the connected with test as it applies specifically to discretionary trusts.

An entity will be taken to control (and therefore be connected with) a discretionary trust where one of the following criteria are met:

- the trustee of trust acts, or could reasonably be expected to act, in accordance with directions or wishes of the entity (either alone or together with its affiliates);¹ or
- if, in any of one of four income years before income year in which CGT event occurs, the entity (alone or together with affiliates) receives at least 40% of all income and capital distributions of the trust.²

As stated, only one of the criteria are required to be met in order to establish a connection – they are alternative tests. In the author's experience, advisers may inadvertently leap to the latter test (sometimes referred to as the pattern of distribution test) when the circumstances of the matter nonetheless readily point to satisfaction of the first test.

The following case study highlights some of the issues associated with establishing a connected with relationship to discretionary trusts that do not trade.

Case Study 1

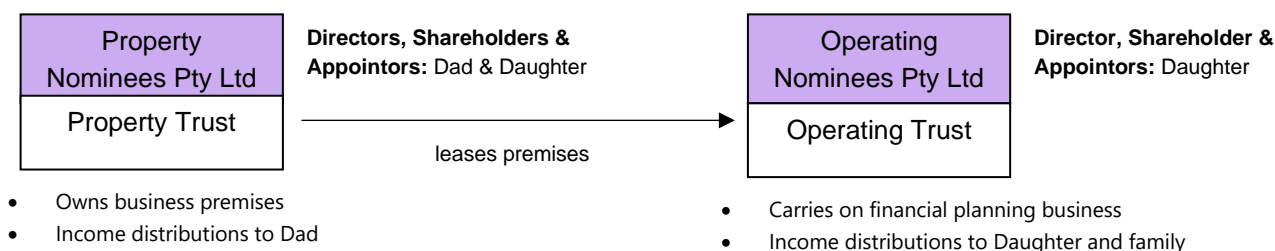
Consider the following circumstances:

- A discretionary trust owns a commercial premises ("**Property Trust**").
- Dad and Daughter are the joint appointors of the Property Trust and the directors and equal shareholders of its trustee, Property Nominees Pty Ltd.
- A further discretionary trust carries on a financial planning business ("**Operating Trust**").
- Daughter is the sole appointor of the Operating Trust and the sole director and shareholder of its trustee, Operating Nominees Pty Ltd.
- The Property Trust leases the commercial premises to the Operating Trust for a fee in order to fund Dad's needs in retirement.
- In this regard, Dad takes income distributions from the Property Trust.

¹ Section 328-125(3).

² Section 328-125(4).

- Meanwhile, Daughter and her family take income distributions from the Operating Trust.



Assume that the commercial premises is being sold by the Property Trust and that there is a need to connect the Property Trust with the Operating Trust for the purposes of satisfying the small business entity test (in the context of passively held assets).³

At a glance, one may expect that the Property Trust and the Operating Trust are connected with each other as the Daughter is involved in both structures.

Nonetheless, the connection may not readily exist without some prior planning. This view is expressed on the basis that:

- The Property Trust does not control the Operating Trust (or vice versa).
- The Property Trust does not make distributions to the Operating Trust (or vice versa).
- The context does not suggest that distributions of at least 40% have been made to the same person across the Property Trust or Operating Trust in the last four income years (in fact the opposite is inferred).
- While Daughter may be taken to control the Operating Trust, Daughter does not have exclusive control of the Property Trust (given the roles assumed by Dad).

An immediate thought may be to make a distribution from the Property Trust to Daughter of at least 40% during the income year of the CGT event (i.e. rely on the pattern of distribution test). This would connect Daughter to the Property Trust and then by extension connect the two trusts.⁴

Importantly, taking this action would not achieve the desired outcome, recognising that the pattern of distribution test will create a connection in the income year following the distribution, not during the year of the distribution.

Of course, if delaying the disposal of the CGT asset is possible, then the above distribution to Daughter could be made in income year one, with the disposal taking place in income year two.

Where the CGT event has already occurred and it is not yet the end of the income year, advisers might consider changing the control of the relevant trust to the desired person - in this example, Daughter could become the sole appointor of the Property Trust as well as sole director and shareholder of its trustee.

In this respect, there is no timing requirement for when a connection must be made under the small business entity test – all that is required under the legislation is that a connection exists at some point during that year.

Naturally, the commercial and succession planning implications of taking this step would need to be considered.

³ Section 152-10(1A).

⁴ Pursuant to section 328-125(1)(b).

2.2 Affiliate Test

An individual or company will be taken to be your affiliate where the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, in relation to the affairs of the business of the individual or company.⁵

The following observations are made in respect of the affiliate test:

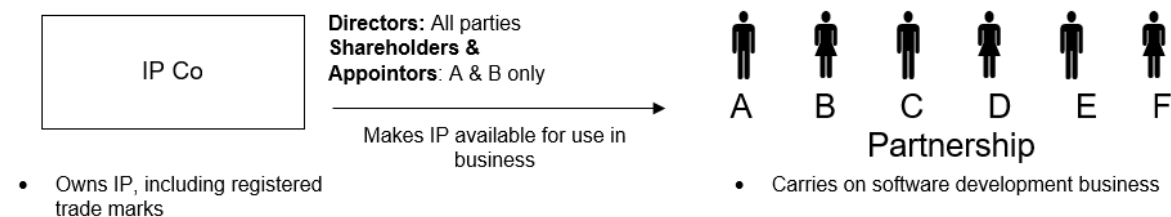
- Non-individual or non-company entities (for tax purposes) such as trusts, partnerships and self-managed superannuation funds are not capable of being affiliates of other such entities. That is not to say that trusts, partnerships or superannuation funds cannot have an affiliate who is an individual or a company.
- Establishing an affiliate relationship is largely a factual exercise, having regard to the informal influence that particular persons may have on other persons.⁶
- While the Commissioner of Taxation has historically adopted a relatively narrow view of the concept of an affiliate,⁷ the Commissioner does not appear to read the words “in relation to the affairs of the business of the individual or company” as requiring that individual or company to actually carry on a business themselves.⁸

The following case study highlights some of the issues associated with establishing an affiliate relationship.

Case Study 2

Consider the following circumstances:

- A private company owns intellectual property, which includes registered trade marks (i.e. CGT assets) (“**IP Co**”).
- A partnership of six individuals in equal shares (A to F) carry on a software development business (“**Partnership**”).
- IP Co makes its intellectual property available to the Partnership for no consideration and there is no written licence agreement in place for the use of the intellectual property (ignoring any potential division 7A issues).
- A to F are the directors of IP Co but only A and B are the shareholders.



⁵ Section 328-130(1).

⁶ See discussion in *White v FC of T* [2012] FCA 109 and *Bell v FC of T* [2012] FCA 1042, being reported cases on the previous concept of “small business CGT affiliates”. As at the date of this paper, there is no reported case law applying the meaning of “affiliate” as that term features in division 328.

⁷ See for instance Private Binding Ruling authorisation numbers 1011464786548, 1011963990391 and 1011949552048.

⁸ For example, see Private Binding Ruling authorisation number 1051961337890.

Assume that some of the trade marks are being restructured into a new company for the purposes of raising capital from external investors. There is a need for an affiliate relationship to exist between IP Co and the partners of the Partnership for the purposes of satisfying the small business entity test in the context of passively held assets (i.e. such that IP Co *together with its affiliates* controls the Partnership for subdivision 328-C purposes).

As a starting point, it should be noted that a partner in a partnership is not an affiliate of another partner merely because of the business relationship they share (as is the case for directors of the same company).⁹ Something more is required by way of a close personal relationship, financial relationships or dependencies or other factors indicating an affiliate relationship.

Although a detailed investigation of the facts would be required in order to make a reasonable conclusion, the following factors may be seen to weigh in favour of an affiliate relationship existing:

- The partners of the Partnership are wholly dependent on IP Co for the conduct of the software development business. Without the use of the intellectual property owned by IP Co, the business cannot be conducted.¹⁰ With this in mind, it might be argued that the partners in the Partnership would act in accordance with the directions or wishes, or in concert with IP Co, in relation to their business affairs.
- A and B, as the shareholders of IP Co, may be considered the controlling minds of IP Co and thus persons who can be seen to hold significant influence over the business activities of the Partnership.

On the basis that an affiliate relationship can be seen to exist, advisers may do well to document the factual basis for the conclusion by way of minutes of the Partnership that are executed contemporaneously with the restructure.

⁹ Section 328-130.

¹⁰ See for instance Private Binding Ruling authorisation number 1052073413400 sought by the author's firm.

3. Aggregated Turnover Test (Small Business Entity Test)

The aggregated turnover test relies on the grouping of annual turnovers.

The term “annual turnover” is defined as the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business.¹¹

Some immediate points can be made:

- “Ordinary income” refers to income according to ordinary concepts.¹²
- The words “in the ordinary course of carrying on a business” do not have an established legal meaning but rather bear their ordinary meaning in the context of facts relating to the particular business being considered.¹³ To derive income in the ordinary course requires the income to arise out of no special circumstances or unusual event.¹⁴
- Statutory income, while assessable income, is not included in annual turnover test. For instance, income arising from trading stock on hand at the end of an income year, income from balancing adjustment events on the disposal of plant and equipment and capital gains on the disposal of CGT assets.
- An entity’s annual turnover excludes GST amounts collected by the entity.¹⁵

In the author’s experience, the gross revenue of an entity as stated in its financial statements may sometimes incorrectly be assumed to accurately reflect the entity’s annual turnover. Such an assumption may unnecessarily deny a taxpayer access to the SBCC, or worse result in a mistaken application of the SBCC where the concessions are not available, where the gross revenue and annual turnover figures do not equate with each other (as will often be the case).

In this respect, the following comments are made with regards to calculating an entity’s annual turnover:

- Amounts derived from dealings between the entity and its connected with entities or affiliates are excluded from annual turnover.¹⁶
- Receipts referable to insurance proceeds, compensation receipts and government grants should constitute ordinary income where those receipts are to replace lost income (for example, insurance proceeds for the loss of trading stock).¹⁷ Conversely, receipts to replace capital assets should not constitute ordinary income (for example, insurance proceeds for the destruction of a building).

¹¹ Section 328-120(1).

¹² Section 6-5(1). Ordinary income is to be contrasted with statutory income which comprises amounts that the legislation deems to be included in a taxpayer’s assessable income. Net capital gains and balancing adjustment assessments are examples of statutory income.

¹³ *Doutch v Federal Commissioner of Taxation* [2016] FCAFC 166, at [77]. This is consistent with the Explanatory Memorandum for the *Tax Laws Amendment (Small Business) Bill 2007* (Cth).

¹⁴ See paragraph 2.15 of the Explanatory Memorandum to the Bill which became the *Tax Laws Amendment (Small Business) Act 2007* (Cth).

¹⁵ Section 328-120(2).

¹⁶ Section 328-115(3)(b) and section 328-115(3)(c).

¹⁷ See, for example, *Carapark Holdings Ltd v Federal Commissioner of Taxation* [1967] HCA 5; *Federal Commissioner of Taxation v Smith* (1981) 147 CLR 578.

- Whether income will be taken to arise out of special circumstances or an unusual event, should be determined in the context of the particular business. For example, a farmer may be forced to bring forward sales of livestock where a natural disaster destroys the dry feed and fencing required to maintain that livestock. This would not typically be considered income arising in ordinary circumstances.¹⁸
- Whether income from the leasing of residential or commercial property constitutes income from the carrying on of a business is a question of fact and degree. Regard must be had to case law principles about when a business is being carried on by the taxpayer, while recognising that the ATO's threshold for leasing activities amounting to the carrying on of a business is high.¹⁹

¹⁸ See Private Binding Ruling authorisation number 1051708495139 sought by the author's firm.

¹⁹ See for instance, Private Binding Ruling authorisation number 1051824727281 sought by the author's firm. Note, however, the decisions of *Allzams Trust v Federal Commissioner of Taxation* [2021] AATA 2767 and *Allen v Federal Commissioner of Taxation* [2021] AATA 2768 which suggest that the threshold may not be as high as traditionally accepted.

4. Maximum Net Asset Value Test

The maximum net asset value test relies on measuring the net value of the CGT assets owned by a particular entity.

By reference section 152-20, the “net value of the CGT assets” is broadly defined to equal:

- the market value (not book value) of the relevant assets;
- less liabilities related to those relevant assets; and
- less provisions for annual leave, long-service leave, unearned income and tax liabilities.

A number of observations can be made in relation to the maximum net asset value test:

- The reference to CGT assets in the test is a legislative reference to the definition of a “CGT asset”. This importantly includes any kind of property, or legal or equitable right that is not property. Hence, for the purposes of the test, a CGT asset extends beyond assets that would ordinarily give rise to capital gains (e.g. it includes depreciating assets).
- The test is a point in time test determined “just before the CGT event” and not at the start or end of an income year.²⁰ Accordingly, advisers may consider extracting value from structures by way of trust distributions or dividends prior to triggering the relevant CGT event.
- The Commissioner takes the view that the market value of an asset should be determined according to the highest and best use of the asset which is not necessarily current use.²¹ Advisers should be particularly conscious of this issue in the context of real property where a business is not engaging the property in its “best use”.
- Where the market value of an asset is uncertain, it is recommended that a valuation (not an appraisal) is sought from a qualified valuer and that this valuation is retained with the taxpayer’s records.
- Interests held by an entity in a connected with or affiliate entity are excluded from the maximum net asset value test calculations.²²
- In determining the net asset value of the CGT assets of the taxpayer’s affiliate or entities connected with the taxpayer’s affiliate, the legislation provides that the calculation should only include assets that are used, or held ready for use, in the carrying on of a business by the taxpayer or another entity.²³ It should be noted, however, that the entities that are affiliates (or entities connected with affiliates) of the taxpayer are a relatively limited category, and these restrictions do not apply to entities connected with the taxpayer.
- Subject to the above issues, all of the assets of a connected with entity are required to be brought into the maximum net asset value test calculations regardless of the percentage of control held by a taxpayer in that entity. For instance, where a taxpayer holds 40% of all the issued shares in a company such that the company is a connected with entity of the taxpayer, the maximum net asset value test brings into account all of the company’s net assets as opposed to just 40%.

²⁰ Section 152-15.

²¹ See ATO publication “Market valuation for tax purposes” on page 4.

²² Section 152-20(2)(a).

²³ Section 152-20(3).

- It is a common misconception that personal use assets and main residences are always excluded from the maximum net asset value test calculations. This exclusion only applies where such assets are held by natural persons.²⁴
- Liabilities are subtracted in the maximum net asset value test calculations where they constitute legally enforceable debts due for payment and to presently existing obligations to pay either a certain or ascertainable sum.²⁵ However, liabilities are only subtracted where they are “related” to the assets of the entity in question.²⁶
- Following on from the above point, contrary to what might be considered the case, unpaid present entitlements and debt accounts between related entities will not automatically be subtracted from the maximum net asset value test calculations. This is because, without anything further, there is difficulty in establishing, for instance, that a credit loan of one trust owing to another trust is a loan that is related to any asset of the first trust. This can lead to an anomalous situation in which the loan is included as an asset of the second trust but then not subtracted from the assets of the first trust.
- Contingent liabilities cannot be subtracted in the calculations. This raises the question of what constitutes a contingent liability, and guidance can be found in the case law on this issue.²⁷

It can be readily seen from the above points that the maximum net asset value test requires careful analysis and, where possible, can benefit from forward planning.

²⁴ Section 152-20(2)(b).

²⁵ Paragraph 1 of ATO Taxation Determination TD 2007/14.

²⁶ Section 152-20(1)(a) and commentary in ATO Taxation Determination TD 2007/14.

²⁷ See, for instance, *Commissioner of Taxation v Byrne Hotels Qld Pty Ltd* [2011] FCAFC 127 in which a real estate agent's commission payable at settlement was found to constitute a liability (and not a contingent liability) just before the time of contract signing.

5. Active Asset Test

5.1 Utilising Trust Nominations

The active asset test requires a CGT asset to be an active asset for a requisite period of time. In turn, a CGT asset is an active asset where it is used, or is held ready for use, in the course of carrying on a business that is carried on by the taxpayer or its connected with or affiliate entities.²⁸

Satisfaction of the active asset test may become problematic where the relevant asset is owned by a discretionary trust that has not made any distributions, or has not made sufficient distributions over the course of the active asset period that are necessary to establish sufficient years of connection between the taxpayer and the discretionary trust. In the latter case, this may be because the trust has derived tax losses in those years such that no distributions were possible.

In the above circumstances, the trustee of the discretionary trust may consider making a nomination under section 152-78. This provision allows a trustee of a discretionary trust to nominate up to four beneficiaries as being the controllers of the trust for any income year for which the trustee did not make a distribution of income or capital if the trust had a tax loss or had no net income for that year. The beneficiaries need not be natural persons, but the beneficiaries must be potential beneficiaries of the relevant trust pursuant to its trust deed. The nomination must be made in writing and signed by the trustee and nominated beneficiaries.

Care should be taken in making a section 152-78 nomination due to potentially unforeseen consequences that may arise. For instance, a nomination may be made to connect a land holding trust with a trading entity for the purposes of satisfying the active asset test, but not to connect the entities during the income year of the relevant CGT event (which could otherwise impact satisfaction of the maximum net asset value test where both entities' assets are aggregated).

5.2 Active Asset Turned Passive

There is a saying amongst tax advisers, "once an active asset, always an active asset". This is fundamentally correct when an asset has been held for at least 15 years and has been active for at least seven and a half years during the test period.²⁹ That is, no matter what the asset is used for after this time, it will always satisfy the active asset test.

Where the above principle can cause trouble is where an asset such as real property that has historically been used in a business carried on by a taxpayer or related entity, begins to be used to derive rental income. This is often in the context of a principal of a business retiring and wanting to derive passive income from the real property as opposed to selling the property. Although the property will have satisfied the active asset test, there is of course a need to revisit the basic conditions for relief in the income year of the CGT event.

Importantly, in context, this requires:

- the taxpayer to be a small business CGT entity during the income year of the CGT event – which will not be the case on the facts;
- the real property to be used by a related entity of the taxpayer that both satisfies the small business entity test and carries on its business in relation to the real property – again, not the case on the facts; and

²⁸ Section 152-40(1).

²⁹ Section 152-35(1)(b).

- the taxpayer to satisfy the maximum net asset value test – which may be the case, but as assets appreciate the test is becoming harder to satisfy for SMEs.

In the above circumstances, it may be that the taxpayer could benefit from effecting an internal restructure to trigger a capital gain before the real property is deployed for rental purposes and apply the small business CGT concessions at this time to obtain a market value cost base uplift.

6. Classes of Shares: Significant Individual Test

The significant individual test may arise in a range of circumstances, such as the additional basic conditions and the 15-year exemption and retirement exemption, as these exemptions apply to company and trust taxpayers.

In the context of companies, certain difficulties may arise where that company has multiple classes of shares on issue.

In this respect, an individual will be a significant individual in a company at a point in time if, at that time, the individual has a small business participation percentage ("**participation percentage**") in the company of at least 20%.³⁰

An individual's participation percentage in a company is equal to the percentage entitlement that the individual has to the voting power in the company, any dividend that the company may pay or any distribution of capital that the company may make because of the individual holding shares in the company.³¹ Importantly however, where these percentages are different, the participation percentage will be the smallest of the percentages. Further, redeemable shares are to be ignored in determining a person's participation percentage in a company.³²

Significantly, the Commissioner takes the view that a company that has different classes of shares and which provides the directors with the ability to pay dividends on one class of shares to the exclusion of others will not have a significant individual.³³

The Commissioner contends that in these circumstances a shareholder of any of the various classes of shares will have no entitlement to dividends and therefore cannot have a participation percentage of at least 20%. In other words, a shareholder in this situation might receive at least 20% of any distribution the company might make or alternatively may not receive anything at all depending on how the directors exercise their discretion.

This view has also been adopted by the Commissioner in various private binding rulings issued by the ATO.³⁴

There is some doubt as to whether the above view of the Commissioner concerning classes of shares is correct, particularly in light of the decision of the Full Court of the Australian Federal Court in *Commissioner of Taxation v Devuba Pty Ltd*.³⁵ That said, it must be acknowledged that the facts of *Devuba* were such that the dividend rights attaching to the particular class of share would only be enlivened upon the directors first resolving that the right to receive a dividend would commence. In the author's experience, this is not a typical arrangement.

Accordingly, advisers should exercise a high degree of caution when dealing with companies that have multiple classes of shares on issue. In circumstances where all classes of shares on issue have identical rights as to voting, capital and the dividends declared on the particular class, it may be that a share conversion is effected in order to have all shares as being in the same class, thus addressing the above issue.

³⁰ Section 152-55.

³¹ Section 152-70(1).

³² Section 152-70(2).

³³ Paragraphs 7 and 8 of ATO Taxation Determination TD 2006/77.

³⁴ See ATO Private Binding Ruling Authorisation Nos. 1051231244722, 1051504800203 and 1051575452695.

³⁵ [2015] FCAFC 168 ("*Devuba*").

7. Buying Time with the Replacement Asset Roll-Over

One of the requirements of the retirement exemption is the need for a natural person taxpayer who is under the age of 55 to contribute an amount equal to the CGT exempt amount to a complying superannuation fund. For company and trust taxpayers, if a CGT concession stakeholder is under 55 just before the requisite payment is made, the company or trust must make a similar payment.

This requirement can often raise commercial issues associated with funding the necessary payments, particularly in the case of internal restructures where no cash funds are being received by the taxpayer or staged settlements/vendor-financed sales.

To this end, the small business roll-over ("**replacement asset roll-over**")³⁶ allows the taxpayer to completely disregard a capital gain where the basic conditions are satisfied and the taxpayer acquires a replacement asset within one year before, or two years after, the CGT event occurs.³⁷

Importantly, it is possible for a taxpayer to apply the replacement asset roll-over without a replacement asset and simply defer the capital gain for two years. For trust and company taxpayers, care should be taken in using this deferral strategy. This is because there is a need for the taxpayer to have a CGT concession stakeholder in the income year in which CGT event J5 occurs.

The following case study demonstrates how the replacement asset roll-over can be utilised effectively.

Case Study 3

Consider the following circumstances:

- Individual is 51 years old (DOB: 1 January 1973).
- The Individual is desirous of applying the SBCC to effect a restructure of CGT assets personally owned to a newly established discretionary trust.
- Restructure of assets occurred on 1 July 2024.

If the Individual chooses to apply the retirement exemption immediately, then the Individual will be required to pay an amount into superannuation on account of being below the age of 55 years at the time of making this choice.

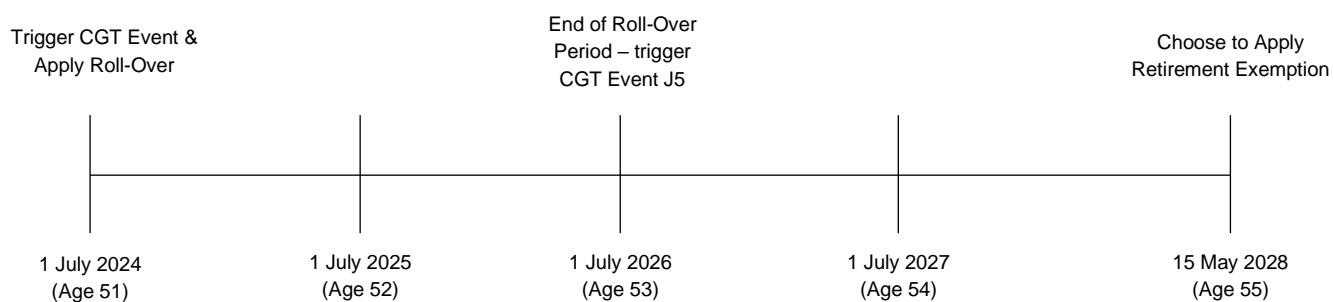
However, if the Individual were to first apply the replacement asset roll-over, then the capital gain would be deferred for two years, crystallising again on 1 July 2026. Significantly, a taxpayer has until tax return lodgement date for the income year in which the CGT occurs to apply the retirement exemption.³⁸ In the case of the Individual, on the basis that the Individual lodges their 2026 year tax return in May 2028, then at this time the Individual will be 55 years of age, thus dispensing the need for the Individual to contribute any amount to a superannuation fund.

³⁶ Contained in subdivision 152-E.

³⁷ Section 104-190.

³⁸ Section 103-25(1)(a).

The timeline below sets out the key dates for the individual.



It can be seen that the use of the replacement asset roll-over can have a considerably favourable outcome for taxpayers within the 55 year age range.

8. 15-Year Exemption: Retirement in Connection with CGT Event

One of the fundamental requirements of the 15-year exemption is the need for the relevant CGT event to happen in connection with an individual's retirement. For individual taxpayers, this is a reference to that individual. For trust and company taxpayers, it is the significant individual for the year of the CGT event.³⁹

But what is precisely meant by "retirement" for the purposes of the concession, and when will a CGT event be taken to "happen in connection with" retirement? These concepts are not defined in the legislation.

The Commissioner sets out his interpretation in the ATO pronouncement, "Small Business CGT Concessions". In this pronouncement, the Commissioner states that "retirement" requires an individual to significantly reduce his or her working hours. Alternatively, the individual is required to undertake a significant change in the nature of their present activities such that the individual can be regarded as retired.⁴⁰

Case law suggests that although there is no need for a direct causal relationship between the CGT event and the individual's retirement, the taxpayer must establish a sufficient relationship or nexus between the CGT event and the individual's retirement.⁴¹ This view is consistent with the view taken by the Commissioner in a number of private binding rulings.

In the abovementioned publication, the Commissioner provides his interpretation of the phrase "in connection with" through a number of examples. Significantly, the examples include situations where a CGT event occurs a considerable time before or a considerable time after the relevant individual retires.⁴²

It is also noted that the Explanatory Memorandum to the bill that introduced the 15-year exemption indicates that the words "in connection with retirement" should be interpreted to suggest that the capital proceeds from the sale are used to fund an individual's retirement rather than the sale precipitating the individual's retirement.⁴³ This is recognised by the Commissioner in a number of private binding rulings favourable to the taxpayer as indicative of an event happening in connection with retirement.⁴⁴ However, it should be noted that the Commissioner has not stated that it is a requirement in every instance for an individual to use the capital proceeds to fund their retirement.⁴⁵

The following case study is intended to flesh out some of the issues advisers may face in addressing multiple CGT events happening in connection with retirement.

Case Study 4

Consider the following circumstances:

- A discretionary trust owns a business premises zoned mix-use.
- The significant individual of the trust is aged 65 and is planning to retire.

³⁹ Section 152-110(1)(d).

⁴⁰ See Small business 15-year exemption ATO Publication (QC 52288).

⁴¹ See in particular the comments of Black CJ in *MIMA v Singh* (2000) 175 ALR 503, at [29] regarding the meaning of the phrase "in connection with".

⁴² See also Private Binding Ruling authorisation number 1051980787245 sought by the author's firm.

⁴³ Paragraph 1.68 to the Explanatory Memorandum to the *New Business Tax System (Capital Gains Tax) Bill 1999* (Cth).

⁴⁴ For example, PBR 1051349050827.

⁴⁵ This issue is absent from the ATO's Small Business CGT Concessions publication as well as the majority of Private Binding Rulings on the 15 year exemption.

- There is a proposal for the trust to subdivide its land into 15 residential allotments and sell the allotments as vacant land to the public.
- All allotments are expected to contract and settle within 12 months.

The case study raises a number of pertinent observations:

- Although it may be expected that the relevant business carried on by the trustee will cease prior to, or during, the subdivision of the business premises, this does not necessarily mean that the individual must retire at this time. In this respect, it may be arguable that the individual's work continues during the winding up of the business and the realisation of its capital assets.
- Each disposal of an allotment will clearly give rise to a separate CGT event as at the date of each respective contract. How comfortable can the taxpayer be in applying the 15-year exemption to multiple capital gains?
- To this effect, there is nothing which expressly prohibits the 15-year exemption from applying to more than one CGT event occurring in respect of a taxpayer. Multiple events may be taken to happen in connection with an individual's retirement.⁴⁶ This is, however, subject to the issue of timing, as multiple CGT events over the course of multiple income years may bring into question precisely when the individual actually retired.
- Accordingly, the individual in the case study may forward plan their retirement to occur on a gradual basis until the final allotment has been contracted for sale (i.e. the individual could wind down their working hours over the course of the 12-month period). This may support each sale being treated as happening in connection with the individual's retirement as it is part of an overall retirement plan.

All in all, there may be scope to treat a number of the above capital gains as arising in connection with the individual's retirement.⁴⁷ That said, it would be strongly recommend that any use of the 15-year exemption, and the circumstances surrounding its use, is documented by way of a detailed trustee resolution in the event of an inquiry by the ATO. It would also be recommended that the position is reviewed each time a sale occurs. This is because the more time that elapses between the sale and the individual's retirement, the greater the risk becomes of failing to establish a sufficient nexus.

An alternative risk-management strategy for the trust in the case study may be to trigger all 15 capital gains simultaneously. This might be achieved by way of internally restructuring all of the allotments before they are contracted for sale to the public. In these circumstances, the individual's retirement in connection with each CGT event may be more readily accepted.

⁴⁶ A view that has in the past been taken by the Commissioner. See for instance, Private Binding Ruling PBR 1011364798982 which concerned the sale of multiple properties.

⁴⁷ Leaving aside preliminary issues such as the revenue/capital distinction.

9. Making CGT Exempt Payments without Sale Proceeds

The SBCC are often applied to eliminate or reduce capital gains arising from internal group restructures where the taxpayer does not receive sale proceeds from the relevant CGT events.

In the context of company and trust taxpayers, it is common to treat the one *in specie* transfer of an asset from a taxpayer to a recipient as both:

- the transaction that gives rise to the CGT event; and
- the payment that is required to be made to a CGT concession stakeholder under section 152-325.

In recent times, the ATO have taken issue with the above treatment.⁴⁸ This is on the basis that, in the ATO's view, the wording of section 152-325 does not allow the CGT event and payment to occur simultaneously – the CGT event must precede the payment.

While the author does not necessarily agree with the ATO's interpretation of section 152-325, taxpayers should be well-advised of the risks associated with adopting an alternative view, being the complete denial of the availability of the retirement exemption.

To address this risk, advisers may look at ways in which the relevant CGT event can be triggered prior to the *in specie* transfer taking place. For example, a sale contract may be drawn up between the parties with a subsequent settlement date. Alternatively, a discretionary trust taxpayer may declare a trust over the CGT asset in favour of the beneficiary, before payment by way of a transfer of the asset takes place. This would appear to address the timing issue raised in some ATO private binding rulings.⁴⁹

⁴⁸ See, for instance, ATO PBR Authorisation Nos. 1051734101042 and 1051733245723.

⁴⁹ See above footnote. See also ATO PBR Authorisation Nos. 1013027694578, 1013008906784 and 1013139540589.

10. Using SBCC in Conjunction with SBRR

There are situations where, in planning to restructuring a group, a taxpayer may qualify for both the SBCC and the small business restructure roll-over ("**SBRR**") contained in subdivision 328-G.

The following table summarises some of the major differences between the SBCC and the SBRR.

	Small Business CGT Concessions	Small Business Restructure Rollover
Turnover threshold	\$2m	\$10m
Criteria	More prescriptive	Less prescriptive
Active Asset Requirement	Active asset test	Active asset at time of CGT event (no equity interests)
Cost base for transferee	Market value cost base uplift	Inherited from transferor
CGT status	Pre-CGT status not preserved	Pre-CGT status preserved
Transfer to SMSF	Yes	No
Consequences	Disregard or defer CGT only	Disregard all direct tax consequences (but deferral only)
Use of CGT Cap	Yes \$1.78m for 2025 income year	No

Where multiple assets are being restructured, a situation may present in which it is beneficial to apply the SBCC to certain assets and the SBRR to other assets. An obvious example is where the taxpayer owns assets with pre-CGT status, and there is a desire to preserve the status of these assets in the transferee. Meanwhile, where the same taxpayer also owns assets with post-CGT status, then there may be a desire to apply the SBCC to receive a market value cost base in the transferee. Can this be done?

In the author's view, it is important to recognise that there is no express prohibition on the concurrent use of the SBCC and the SBRR under the tax laws. Nor is there an express requirement under either of the concessions to apply the concessions to each and every asset transferred as part of a restructure. To the contrary, such concessions have been specifically legislated on the basis that a taxpayer can choose to apply the concessions on an asset-by-asset basis.

With particular regard to the SBRR, the Commissioner expressly accepts that transferring only some of the assets required for the ongoing conduct of a business is not inconsistent with there being a genuine restructure of an ongoing business.⁵⁰

The author does not consider that the concurrent use of SBRR and SBCC relief should give rise to a general anti-avoidance issue. However, even if it did, the taxpayer would only be making a choice for which the income tax legislation specifically provides in concurrently accessing the SBRR and SBCC. Part IVA of the *Income Tax Assessment Act 1936* (Cth) (the general anti-avoidance provisions) expressly provides that making such a choice

⁵⁰ Paragraph 11 of LCR 2016/3.

cannot amount to a tax benefit.⁵¹ Therefore, provided that the relevant restructure is properly documented on this basis, the taxpayer should be able to access both the SBRR and SBCC.

⁵¹ Section 177C(2) of the *Income Tax Assessment Act 1936* (Cth).

11. Concluding Remarks

The SBCC present ever-evolving trips and traps for tax advisers, who must take particular care and caution when expressing a view on their availability and documenting their application.

It is hoped that this paper has highlighted some of the more nuanced issues in the application of the SBCC and raised some potential solutions for advisers to consider.

The law in this area is increasingly complex and the wide variety of factual circumstances make it a highly challenging, but nevertheless, rewarding area of practice for advisers.