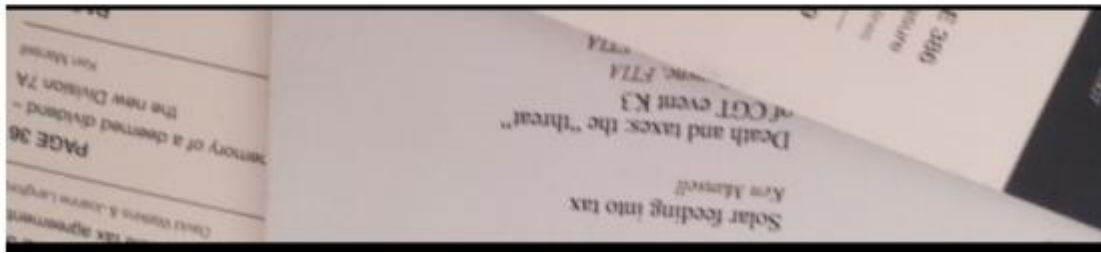


Small Business Restructures and Contributing to Super

1. Objectives	2
2. Case Study	4
3 The small business restructure rollover	6
3.1 In Summary... ..	6
3.2 Genuine restructure	6
3.3 Small Business Entity.....	8
3.4 The Ultimate Economic Ownership	8
3.5 An Active Asset	9
3.6 Federal Taxes Only	11
3.7 Division 7A.....	14
3.8 The CGT Discount.....	14
3.9 Effect on 15 year CGT exemption	15
3.10 Pre-CGT assets	15
3.11 It's optional.....	15
3.12 Residency	16
3.13 SMSFs	16
3.14 Tax planning	16
3.15 New membership interests issued as consideration for the transfer.....	16
3.16 Back to the case study for a last look at the small business restructure rollover	16
4. Restructuring using the small business CGT concessions	18
4.1 Do we have an Active Asset?	19
4.2 Do we have a small business entity (or have less than \$6m maximum net assets)?	19
4.3 Do we have the right ownership so we can do the restructure?	19
4.4 Can we use the 15-year exemption to achieve the rollover?	21
4.5 Can we use the \$500,000 lifetime concession?	22
4.6 The mechanics of getting these the amounts into super.....	25
4.7 What if I am about to no longer be a small business?.....	26
5. So which one would you use and why? What advice would you give Chris and Vicky?.....	27



1. Objectives

Often small businesses are initially set up in the cheapest and simplest way, and this makes a lot of sense. As most small businesses never grow to any substantial size and many are just closed down shortly after starting, spending lots on the optimal structure just in case the business grows substantially hardly seems worthwhile.

But this means we often see new clients who have less than optimal structures.

Assets that are not protected from the risks of the business, there is no easy way to bring in new equity owners, income can only be provided to a small group of the family owning and running the business, and there is limited access to many of the CGT concessions that are available.

In this session we will consider how to fix these problems – how to take the cheap and simple structure of either a sole trader owning everything, or just the same but all done in a shelf company, and ensure that asset protection, bring in new equity, income splitting and the CGT concessions are available.

Before 1 July 2016 there was one main way to fix this problem, using the small business CGT concessions. However, from 1 July 2016 there is a second option, using the small business restructure rollover in the proposed new Subdivision 328-G in the Tax Laws Amendment (Small Business Restructure Roll-over) Bill 2016.

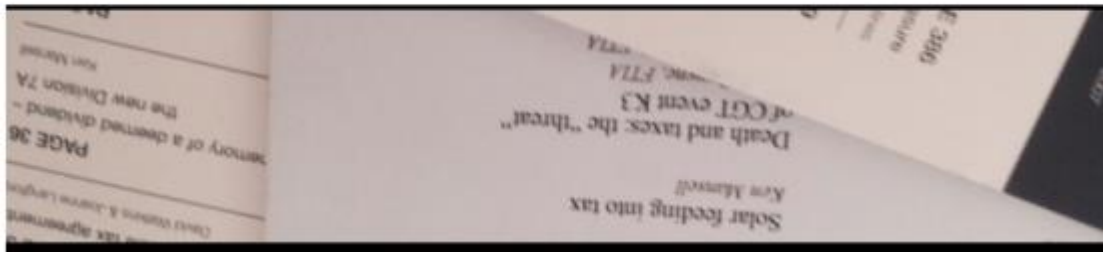
So which is better to use? What are the benefits of these two options? And what are the problems each has?

And can we use this to get around the new super rules? From 1 July 2017, many individuals will not be able to make any substantial super contributions (no non concessional contributions) if they has a total superannuation balance of \$1.6million+. Can we use these restructure rules to get around this?

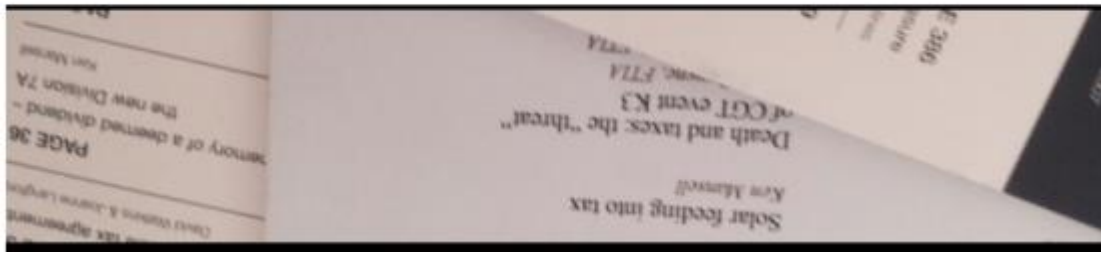
By the end of this session we will have considered all of these questions.

Therefore, the objectives of this session are to:

- Understand how the small business CGT concessions can be used to restructure a small business;



- Understand how the small business restructure can be used to restructure a small business; and
- Understand the pros and cons of each of these two methods.



2. Case Study

Throughout this session we will consider the following case study and at the end decide what is the best way to restructure this small business...

"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.

Puppy Co has successfully carried on a puppy training school and has acquired significant assets including puppy boarding facilities, a vehicle, and goodwill.

The boarding facilities have a cost base of \$250,000 and have a market value now in the range of \$500,000 to \$700,000. It was purchased 12 years ago. There is still a \$50,000 mortgage on the boarding facilities in the name of the company but with a guarantee from Chris and Victoria.

The goodwill has a cost base of \$50,000 as the company purchased the business 12 years ago. There have been people interested in buying the business previously, including discussions 2 years ago with a key employee to buy the business for \$100,000 and lease the premises from Chris and Victoria.

Chris and Vicky take a salary each week of \$250 each (\$13,000 each a year) and the rest of any profit is paid as a dividend each quarter. These dividends are generally around \$15,000 to \$20,000 each year for each shareholder (grossed up).

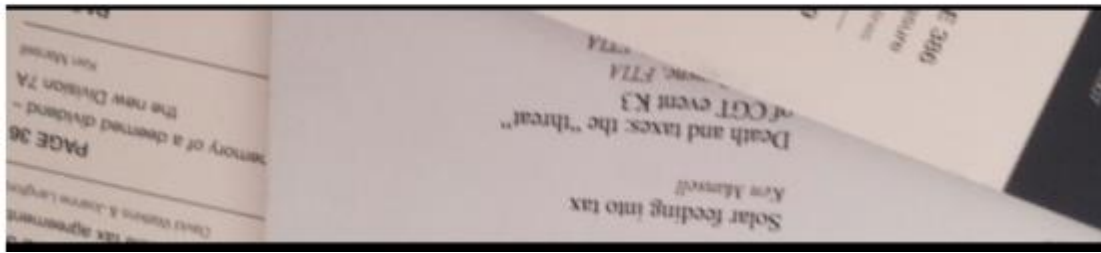
So the company tax return has a taxable income of say \$34,000 (on which \$10,100 is paid in company tax) and each individual tax return has \$13,000 salary, a \$17,000 grossed up dividend, with a \$5,100 imputation credit.

Chris is 53 and Victoria is 56. They have one child, Joshua, who is going to be a perpetual university student and has just started his 6-year PHD.

Chris and Victoria has an SMSF and it holds listed shares worth \$4 million (each has an interest of \$2 million).

Lets start by discussing what would be the preferred structure for this business would be. And remember, the structure should cover:

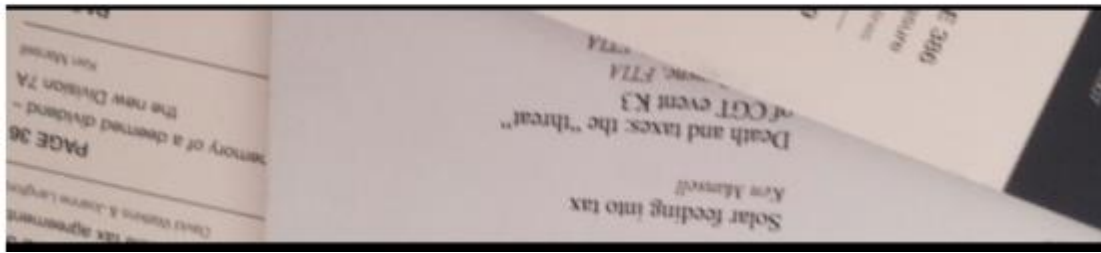
- Asset Protection;
- Income Splitting;
- Access to the CGT concessions for future sale of CGT assets; and
- The ability to maximise superannuation contributions.



So what structure do you want?

A large, empty rectangular box with a black border, intended for a user to draw or write a response to the question 'So what structure do you want?'.

Now lets look at how we are going to get to this structure, by either using the small business CGT concessions or the small business restructure rollover



3 The small business restructure rollover

3.1 In Summary...

The small business CGT rollover is currently only in a 328-G of the ITAA97

Under this subdivision, from 1 July 2016, small businesses can roll-over “active assets” that are CGT assets, trading stock, revenue assets and depreciating assets as part of a genuine restructure of a small business from one entity to another.

In summary, here is how it works:

Subdivision 328-G creates an optional rollover where a small business entity transfers an active asset of the business to another small business entity as part of a genuine business restructure, without changing the ultimate economic ownership of the asset.

Each of these terms needs to be understood.

3.2 Genuine restructure

The first of these terms we need to understand is what is a “genuine restructure”?

In the Explanatory Memorandum that introduced this new rollover to the Parliament, the Government makes it clear that they could not come up with a solution to all the tax savings ideas that this rollover could create so they have added the “genuine restructure” rule. As they state in the EM:

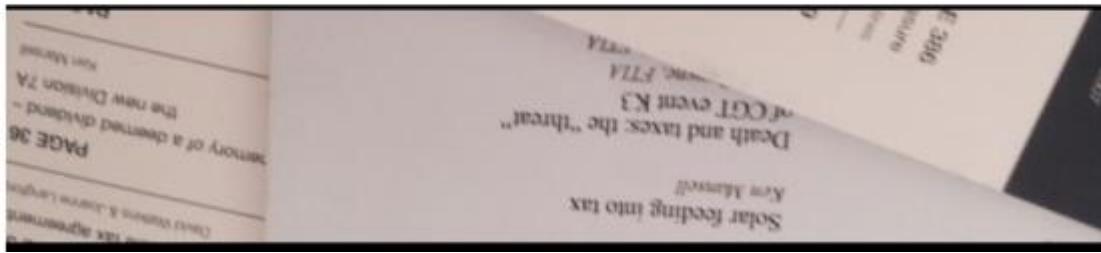
“The genuine restructure principle distinguishes genuine restructures from artificial or inappropriately tax-driven schemes. This acknowledges that while tax considerations are significant factors in small business structuring, a minority of taxpayers and advisers may try to manipulate the operation of a ‘black letter’ provision of the tax law to achieve an inappropriate or uneconomic tax outcome.”

So if you have a company with lots of assets and a Division 7A loan and you transfer all the assets other than the loan (which you can’t transfer as it is not an active asset) for no consideration so that there is no distributable surplus left in the company so you can forgive the loan, this may not be a “genuine restructure”.

There is no definition in the legislation as to what is a “genuine restructure”. Therefore, whether a restructure is “genuine” is a question of fact.

For examples a genuine restructure could be:

- A bona fide commercial arrangement undertaken to enhance business efficiency;



- Where a business continues to operate following the transfer, through a different entity structure but under the same ultimate economic ownership;
- Where the transferred assets continue to be used in the business;
- Where the restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business;
- Where the restructure is not artificial or unduly tax driven; and
- Where the restructure is not a divestment or preliminary step to facilitate the economic realisation of assets.

There are a series of examples of what is a genuine restructure in Law Companion Guideline LCG 2016/3, titled “Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters”.

Examples include asset protection, equity investments and simplifying a business structure. However, it does not include succession planning or restructuring just to extract wealth.

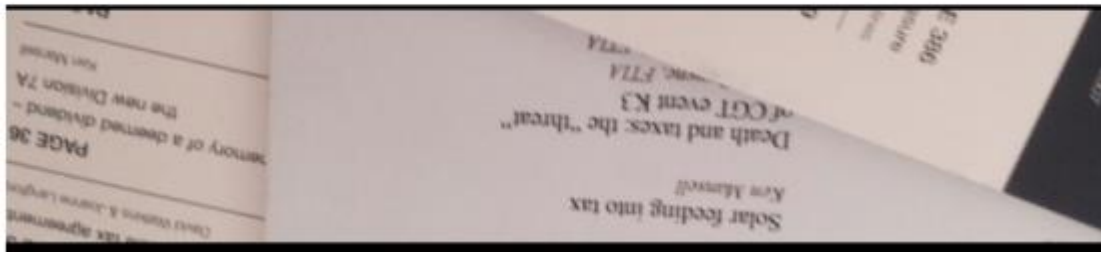
There is a safe harbour for the “genuine restructure” rule (section 328-435). If, for three years following the rollover:

- 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.

Then you have a genuine restructure.

Case Study

Do you think your proposed restructure of the business in the case study will be a “genuine restructure”? Why or why not?



3.3 Small Business Entity

This is the definition we all know (carrying on a business and passes the \$2 million turnover test and the other tests in Subdivision 328-C) but also includes the affiliates, connected entities and partners of a small business. This could be \$10 million from 1 July 2016 but the Government has not got the appropriate Bill through the Parliament.

This new rollover is placed in Division 328 where all the rules about small business entities, and the various concessions, are.

So to use this rollover, each party to the transfer must be either:

- A small business entity for the income year during which the transfer occurred;
- An entity that has an affiliate that is a small business entity for that income year;
- Connected with an entity that is a small business entity for that income year; or
- A partner in a partnership that is a small business entity for that income year.

3.4 The Ultimate Economic Ownership

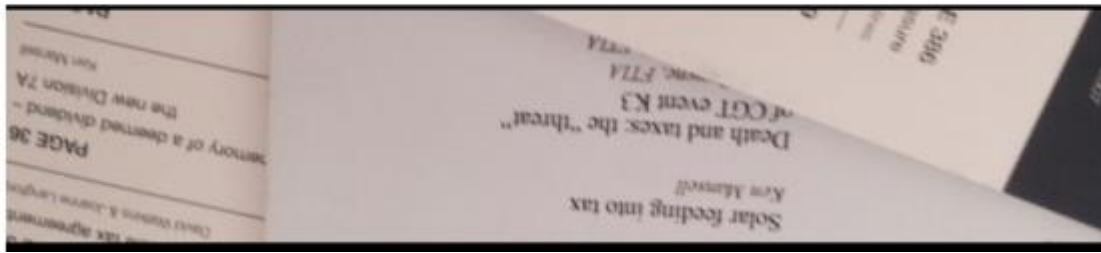
To be eligible for the rollover the transaction must not have the effect of changing the ultimate economic ownership of transferred assets in a material way.

Natural persons can only hold ultimate economic ownership of an asset. Therefore, where a company, partnership or trust owns an asset it will be the natural person owners of the interests in these interposed entities that will ultimately benefit economically from that asset.

If there is more than one individual who is an ultimate economic owner of an asset, there is an additional requirement that each of those individuals' shares of that ultimate economic ownership be materially unchanged, maintaining the same proportionate ownership in the asset (paragraph 328-430(1)(c)(ii)).

Now this is easy to assess for all entities other than discretionary trusts.

You can roll into (or out) of a discretionary trust if all the original owners (or the new owners) are covered by a family trust election over the discretionary trust (section 328-440).



Case Study

Does your proposed plan for restructure meet the underlying economic ownership test? If you used a discretionary trust who can (and should) be the test individual on the family trust election?

I do love it that the EM shows exactly how we will use this rollover time and time again in example 1.3 (and yes, this does explain where the start of the case study comes from):

“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.

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 rollover, 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.”

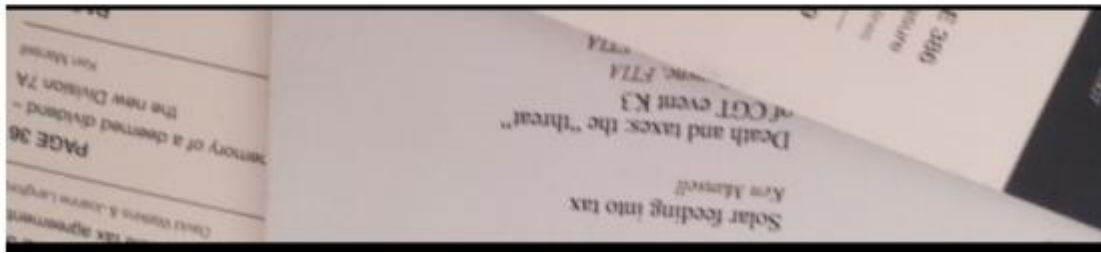
3.5 An Active Asset

To be an active assets it must be a CGT asset that is used, or ready for use, in a business being carried on by you, your affiliate or an entity connected with you.

Obviously this does not include passive assets like assets producing passive income, interest, annuities, rent and royalties.

A CGT asset will be an active asset if the asset is an intangible asset that is inherently connected with a business carried on by the people indicated above. The following are examples of intangible assets:

- The goodwill of a business;
- The benefit of a restrictive covenant; and
- Intellectual property rights.



But the asset does not always have to be an active asset... A CGT asset satisfies the active asset test if:

- You have owned the asset for 15 years or less and the asset was an active asset of yours for a total of at least half of the period; or
- You have owned the asset for more than 15 years and the asset was an active asset of yours for a total of at least 7 1/2 years during that period.

A share in an Australian resident company or interest in an Australian resident trust will qualify as an active asset if the total of:

- The market values of the active assets of the company or trust; and
- 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
- 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.

Case study

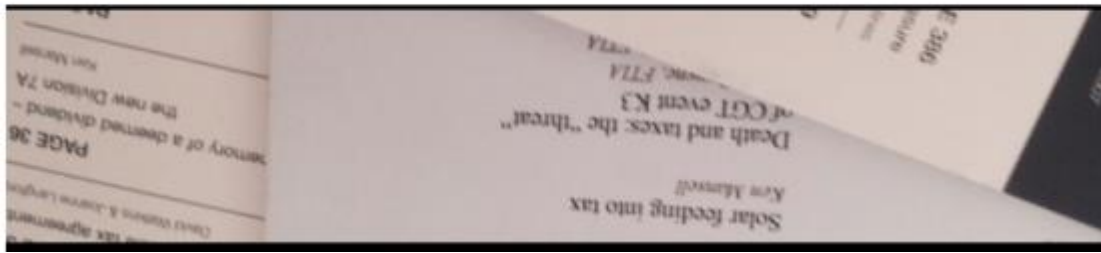
Do you think the assets you want to roll over are active assets? And what could the company hold that is not an active asset?

To quote from the EM of the bill that introduced the rollover...

Example 1.4

Continuing Example 1.3 above, the business premises are an active asset of the business carried on by Puppy Co, and will satisfy subsection 152-10(1A) in the hands of the Fluffy Trust. The premises can be transferred to the Fluffy Trust, provided the other requirements of the rollover are satisfied.

But what is an example of an asset I can't roll out of the company due to it not being an active asset? Due to the Division 7A opportunities, like the one discussed above, the EM states that assets such as loans to shareholders of a company are not active assets.



“A purported transfer of such assets to the debtor shareholder, or trust liable to pay the unpaid distribution could potentially defeat the operation of Division 7A of Part III of the Income Tax Assessment Act 1936 (ITAA 1936). The rollover cannot be used for such transfers.

Example 1.5

Mr and Mrs Smith are directors and shareholders of private company ABC Pty Ltd. They each own 50 shares in ABC Pty Ltd, which operates the family business of a milk bar.

Due to the administrative burden of operating a private company,

Mr and Mrs Smith decide to restructure their business affairs. They use the small business restructure rollover and transfer all plant and equipment of the milk bar to a newly formed partnership.

A complying Division 7A loan for \$50,000 to Mr Smith also exists in the balance sheet of ABC Pty Ltd. The Division 7A loan cannot be transferred to the partnership as it not an active asset, and the normal operation of Division 7A continues to apply in respect of the loan.”

3.6 Federal Taxes Only

The rollover is very broad, applying to CGT assets, revenue assets, trading stock and depreciable assets. But it does not cover all the taxes that may be rolled over under these restructures.

Clearly this does not cover State and Territory taxes, like stamp duty.

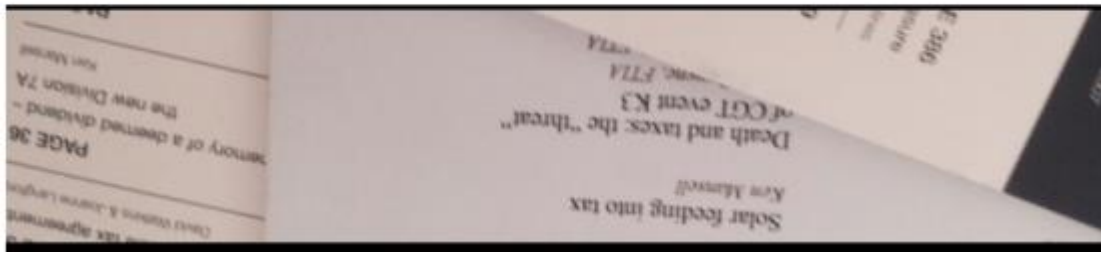
Therefore, before recommending the use of this rollover it is important to assess if, and what amount of, stamp duty is payable.

Case Study

In the case study above, you probably considered rolling the land and buildings out of the company and into another structure.

You probably concluded this, as it would move the asset from the business, giving it greater asset protection. You also may have done this to allow new owners to buy into the business without having to buy a share of the land and building. And while not the “dominant purpose” of undertaking the restructure, you probably chose to roll the land and buildings into a trust to get the CGT discount on a future capital gain, and decided to make that trust a discretionary trust to get asset protection.

The transfer of the buildings and land will see stamp duty payable. In NSW the current rate is \$8,990 plus \$4.50 for every \$100, that the value exceeds \$300,000 so the stamp duty would be \$22,490 if the land and buildings were sold for \$600,000, the mid point of the agreed market value range.



But is there a way we can avoid this cost? See if you can think of a way...

In NSW, as duty on the transfer of business assets or a declaration of trust over 'business assets' (other than land) will be abolished from 1 July 2016 you could consider keeping the land and buildings in the company and moving the "business" out of the company to another entity. Of course this would mean the land and buildings still get no access to the CGT concession. Also, income splitting, assuming the business was rolled to a discretionary trust, would only apply to the profits of the business, which would be reduced by the rent costs the company holding the land would charge the business...

So is the future access to the CGT concessions worth \$22,490 payable today?

If the company sold the land and buildings today for \$600,000, with a cost base of \$250,000, the gain would be \$350,000. The Small business CGT concession 50% active asset reduction is pretty useless as it just creates an unfranked dividend so I would not apply it here. That means at 30% the company has to pay \$105,000 in tax.

But if the land and building were transferred to a trust, and the trust could apply the discount by meeting the 12-month holding rule, the capital gain is reduced to \$175,000. Even if a taxpayer on the highest marginal tax rate (49%) is made presently entitled to this gain, the tax payable is now \$85,750, a reduction of just under \$20,000. Of course, if you can find a beneficiary of the trust on a lower tax rate to reduction in tax can be even less.

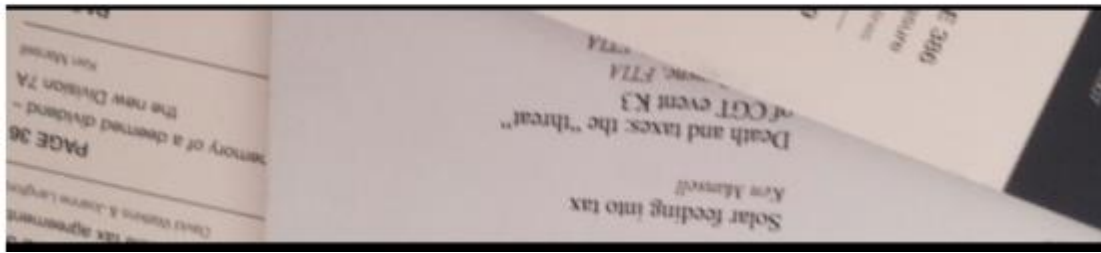
Case Study

So would you recommend taking the stamp duty cost today, in the light of the future capital savings?

But perhaps there is another way to avoid the stamp duty all together.

In most jurisdictions there are "corporate restructure" relief rules in the Duties Act. And if we were happen to forgo the income splitting benefits that we get from rolling assets into a discretionary trust, then we might be able to avoid the stamp duty on the sale of the property from the Company to a trust.

If the trust was a unit trust, not a discretionary trust, then all the units in the unit trust have to be owned by the same underlying economic owners. This would be the case



if the company from which we intend to roll the assets out of owns all of the units in the unit trust.

In NSW, section 273B of the Duties Act 1997 states:

Duty under this Act is not chargeable on a transaction if the Chief Commissioner is satisfied, on application by a party to the transaction, that:

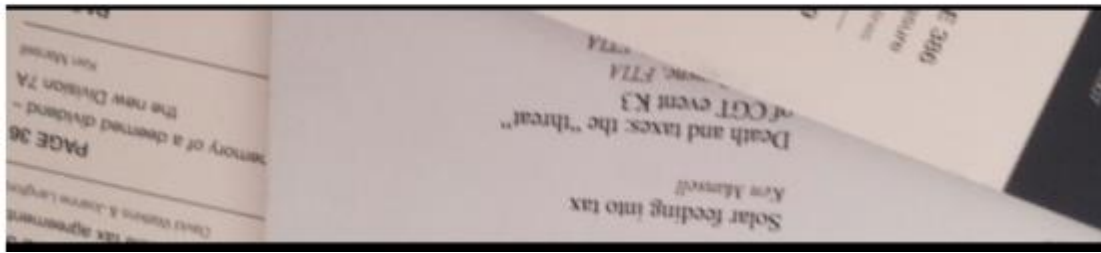
- (a) the transaction is a corporate reconstruction transaction, and*
- (b) the transaction, or the series of transactions of which the transaction is a part, is undertaken for the purpose of either or both of the following:*
 - (i) changing the structure of a corporate group,*
 - (ii) changing the holding of assets within a corporate group, and*
- (c) the transaction, or the series of transactions of which the transaction is a part:*
 - (i) is not undertaken for a purpose of avoiding or reducing duty under this Act on another transaction, and*
 - (ii) is not undertaken for the sole or dominant purpose of avoiding or reducing a liability for tax, other than duty under this Act, under a law of an Australian jurisdiction.*

Note, that to get this you need to apply first to the Commissioner in each state or territory and there are different processes and timeframes for this approval in different jurisdictions.

Also note that while the term “corporate” is used in the definition about, a unit trust that is wholly owned by a company can be a part of a “corporate group” in the NSW Duties Act.

Case Study

So would you consider rolling the land and buildings into a unit trust that is wholly owned by the company in the case study facts if the Commissioner of Taxation in NSW agreed this was an exempt “corporate reconstruction under Part 1 of Chapter 11 of the Duties Act 1997 (NSW)?



3.7 Division 7A

And remember that using this rollover can create other tax problems...

Dean operates a fishing tour business through a company, where he is the sole director and shareholder. The active assets of the business include a fishing boat, which cost the company \$300,000.

In January 2017, a discretionary trust is set up, Dean is one of the beneficiaries and a family trust election is made with Dean as the primary individual. The termination value and adjustable value of the boat is \$260,000 at this time.

The company transfers the boat to the trust for \$260,000 as consideration, payable within 60 days. Both the company and the trustee choose to apply the SBRR.

The trustee does not pay at that time and enters into a written loan agreement that complies with the requirements of section 109N of the ITAA 1936.

In June 2018, the company executes an effective deed to forgive the loan.

Other tax consequences are recognised

A transfer of an asset has no direct income tax consequences, except as provided for under Subdivision 328-G. Related rollover relief for depreciating assets is available under section 40-340.

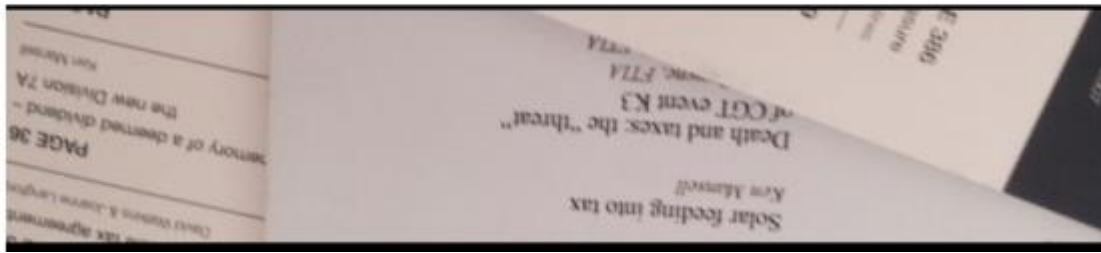
The subsequent application of Division 7A to the loan, which was created in connection with the transfer of the assets, is an indirect consequence of the transfer and is not turned off by section 328-450. The forgiveness of the loan or failure to make minimum yearly repayments may give rise to a deemed dividend under Division 7A.

So Dean should have transferred the assets for no consideration. There is more on this in Law Companion Guideline LCG 2016/2, titled "Small Business Restructure Roll-over: consequences of a roll-over."

3.8 The CGT Discount

As soon as this rollover was announced in the 2015 Budget, we knew it would allow us to roll a CGT asset from a company that cannot use the 50% discount, to a trust that can. We even wondered if we could do the rollover 1 minute before the CGT event to get the CGT discount on the entire capital gain.

The legislation implementing the rollover tried to solve this problem by making the time period for eligibility for the CGT discount will recommence from the time of the transfer. To quote from the EM:



“This is consistent with the policy intent of the roll-over, which is to make it easier for small business owners to change the legal entity or entities that run the business in the course of a genuine restructure of an ongoing business. The policy is not to facilitate the transfer of assets to an entity that is entitled to the CGT discount shortly before the sale of the asset.”

So you can still do the roll to a trust to get the discount, you just need to do it a year in advance (and as a part of a genuine restructure as discussed above).

Case Study

What risks does this mean for undertaking a restructure? What if someone offers to buy the business shortly after the rollover?

There is a real risk here if a restructure occurs where the original owner before the rollover, and the entity that acquires the assets under the rollover, could claim the CGT discount. If the small business rollover is between an individual and a trust, and in the year following the rollover, the trust agrees to sell the business (the CGT event), there will be no access to the CGT discount... Ouch.

3.9 Effect on 15 year CGT exemption

For the purpose of determining eligibility for the 15 year CGT exemption for small businesses, the transferee will be taken as having acquired the asset whether the transferor acquired it (subsection 152-115(3)).

Case Study

Why is this such good news for our restructure?

3.10 Pre-CGT assets

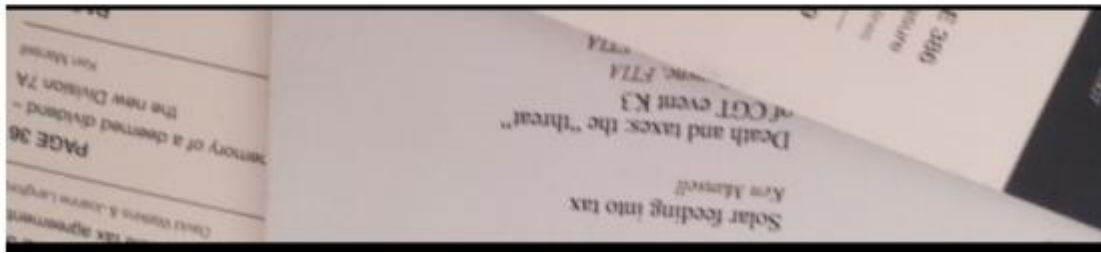
Pre-CGT assets transferred under the rollover will retain their pre-CGT status in the hands of the transferee (section 328-460).

3.11 It's optional

Need I say more (paragraph 328-430(1)(f))...

So lets say this is the last year you will be a small business entity due to turnover growth and you want to use the \$500,000 lifetime concession to put an amount into super so you want there to be a CGT event...

Lets save that for part 2 of this paper.



3.12 Residency

To be eligible for the rollover, both the transferor and the transferee of the assets must be residents of Australia (paragraph 328-430(1)(e)).

3.13 SMSFs

The rollover will not apply to a transfer to or from an exempt entity or complying superannuation entity (subsection 328-430(2))

3.14 Tax planning

The government is obviously concerned some taxpayers will look to “misuse” this rollover. Therefore they have put in lots of integrity rules – in addition to the “Genuine restructure” rule discussed above.

The Bill makes it clear that Part IVA, containing the general anti-avoidance provisions of the taxation law, can apply to a scheme involving the application of the rollover.

The Bill also has an integrity rule (called the loss denial rule) to ensure that a capital loss on any direct or indirect membership interest in the transferor or transferee that is made subsequent to the rollover will be disregarded, except to the extent that the taxpayer can demonstrate that the loss is reasonably attributable to something other than the roll-over transaction.

Case study

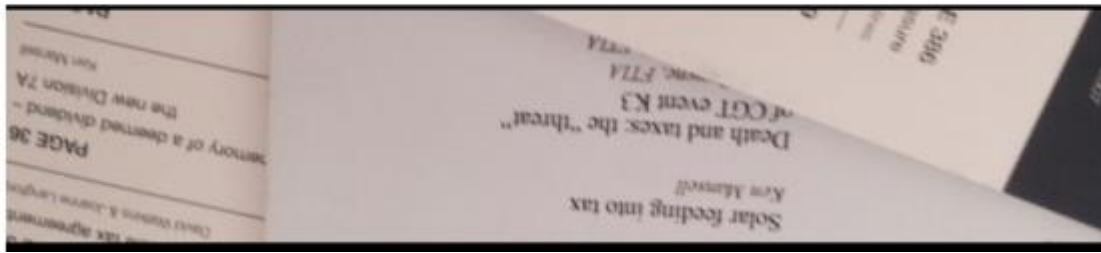
So if we roll the land and buildings out of the company and the new trust buys it at its cost base (vendor financed – but note that it could be provided at no consideration or even at market value as there is nothing that requires a certain purchase price), can we then sell some of the shares in the company to a new investors and make a capital loss?

3.15 New membership interests issued as consideration for the transfer

Where membership interests are issued in consideration for the transfer of a roll-over asset or assets, the cost base and reduced cost base of those new membership interests is worked out based on the sum of the roll-over costs and adjustable values of the roll-over assets, less any liabilities that the transferee undertakes to discharge in respect of those assets, divided by the number of new membership interests.

3.16 Back to the case study for a last look at the small business restructure rollover

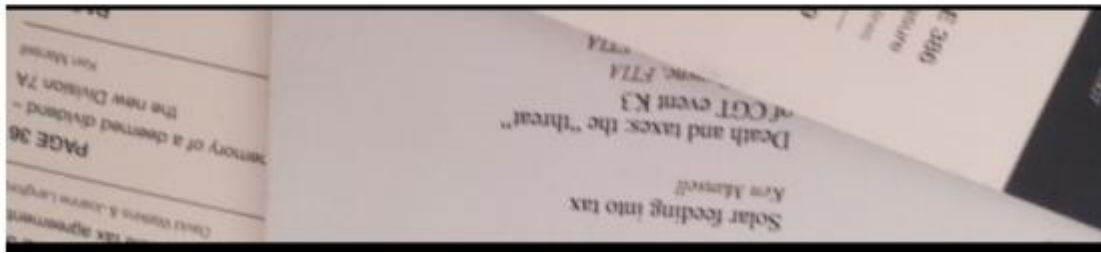
In summary, here is how it works:



Subdivision 328-G creates an optional rollover where a small business entity transfers an active asset of the business to another small business entity as part of a genuine business restructure, without changing the ultimate economic ownership of the asset.

Case Study

What advice are you going to give to Chris and Vicky?



4. Restructuring using the small business CGT concessions

Given that the small business rollover is so amazing (as we have just seen), why would we even consider electing not to use it, but rather apply the small business CGT concessions...

Superannuation.

One of the main purposes of the small business CGT concession is to allow small business owners, who generally don't build up substantial superannuation balances, to put some or all of the gains they make from the sale of their small business into superannuation.

Outside of the deductible pre tax contributions (\$25,000 a year) and the post tax contributions (\$100,000 a year or \$300,000 over three years), the small business CGT concessions allow substantial contributions to be made to superannuation.

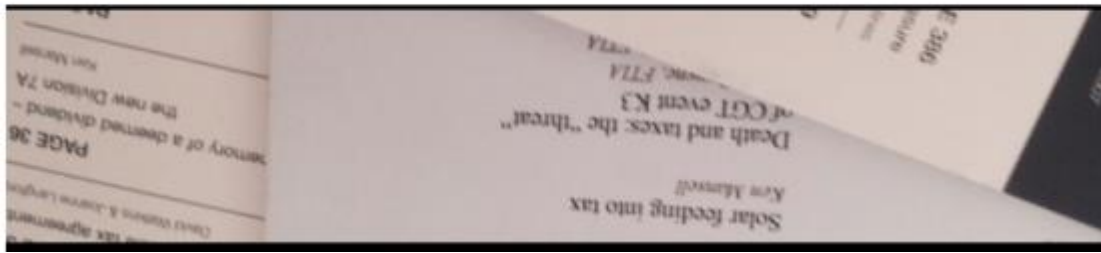
And remember that if an individual has a total superannuation balance of greater than \$1.6m at 30 June then in all subsequent years they will not be able to make any non concessional super contributions at all...

So rather than applying the small business restructure rollover, a taxpayer may want to crystallise the capital gain as a part of the restructure and instead apply the small business CGT concessions to put the gain, or in some cases the entire market value, into superannuation.

For example if you own a small business that shortly will no longer be a small business entity, due to the maximum net assets and the turnover, you are about to lose the ability to make these additional superannuation contributions. SO why not undertake a restructure, opt not to apply the small business restructure rollover, use the small business CGT concessions, get a cost base uplift and put the potentially tax free capital gain that you have crystallised in the restructure into superannuation.

Sounds good doesn't it!

But to be able to do this we need to make sure we meet all of the requirements of the small business CGT concessions, then we need to ensure we can claim the 15 year exemption or the \$500,000 lifetime concession and finally we need to ensure we can put the amount into superannuation. So lets start by quickly looking at the three basic questions for assessing if we can apply the small business CGT concessions.



4.1 Do we have an Active Asset?

In order for any of the small business CGT concessions to apply the asset that is being sold (or assets), need to be an active asset. This was discussed in detail earlier under the Small Business Restructure Rollover, which also requires the assets to be active assets.

4.2 Do we have a small business entity (or have less than \$6m maximum net assets)?

To claim the small business CGT concessions the entity needs to be a small business entity or have less than \$6m maximum net assets. The small business entity test was discussed earlier under the Small Business Restructure Rollover.

The \$6 million maximum net asset test could be its own session so we will not have the time to consider these rules in detail. If you need to consider this have a look at the "Advanced guide to capital gains tax concessions for small business" produced by the Commissioner of Taxation.

4.3 Do we have the right ownership so we can do the restructure?

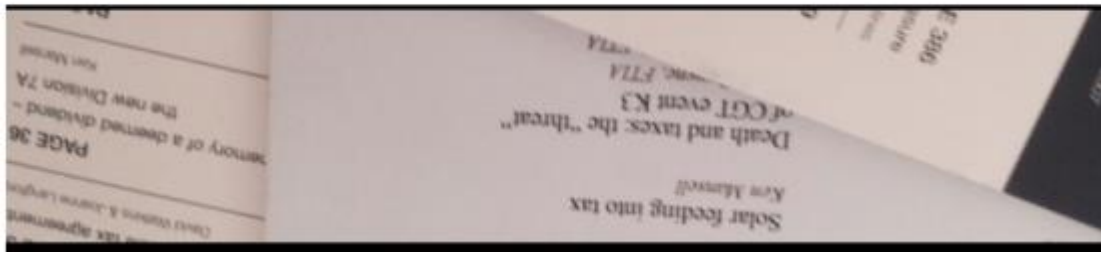
There are a couple of times we need to consider if we have the right "ownership"?

The first is if the CGT asset is a share in a company or an interest in a trust. If this is the case, one of the following additional basic conditions must be satisfied just before the CGT event:

- The taxpayer is a CGT concession stakeholder in the object company or trust; or
- CGT concession stakeholders in the company or trust together have a small business participation percentage in the taxpayer of at least 90%.

So what is a CGT concession stakeholder? An individual is a CGT concession stakeholder of a company or trust if:

- They are a significant individual in the company or trust; or
- They have some participation percentage in the company or trust and they are the spouse of a significant individual in the company or trust.



So what is a significant individual? An individual is a significant individual in relation to a company or trust if they have a 'small business participation percentage' of at least 20%.

An individual's small business participation percentage is their total direct and indirect interest in the income and capital of the relevant entity (including voting power for a company). If each of these interests are different for an individual (25% of the income and 5% of the voting) the lowest is the percentage (5%).

For a non-fixed trust, it is the lesser of the individual's entitlements to:

- Any distributions of trust income made in the year of the CGT event; or
- Any distributions of trust capital made in the year of the CGT event.

Indirect participation percentages are calculated by reference to the direct interests of an interposed entity in the subject entity. For example, if Peter owns 40% of Tealy Co, and Tealy Co owns 50% of Mansell Co, then Peter's indirect participation percentage in Mansell Co is $40\% \times 50\% = 20\%$.

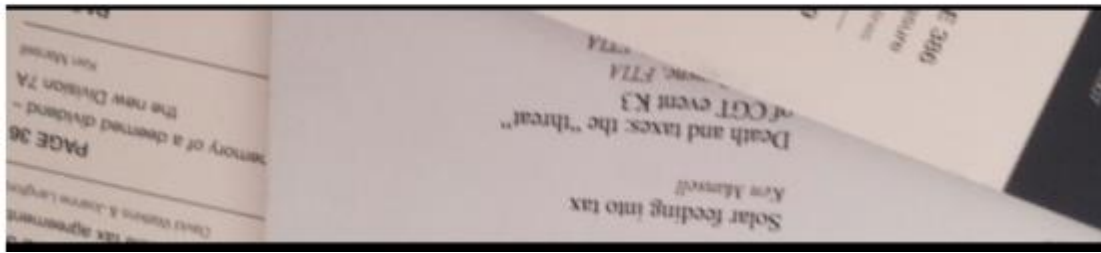
The second time when there needs to be the right ownership is when the taxpayer selling the asset is a company or a trust. There has to be a significant individual of the company or the trust or company just before the CGT event.

NOTE: Where a partnership disposes of an 'active asset', the significant individual test does not apply as each partner will be disposing of their interests in the partnership CGT assets i.e. you apply the small business concessions to the partners (not the partnership).

NOTE: As the significant individual test need only be satisfied just before the CGT event, it is possible to undertake some tax planning before the asset is disposed of to ensure the significant individual test will be satisfied.

NOTE: Therefore, it is possible for a company or trust to have up to 8 CGT concession stakeholders at any time - 4 individuals with at least a 20% participation percentage and their 4 spouses with at least some participation percentage.

The third and fourth time we need the right ownership is when we attempt to apply the 15-year exemption and the \$500,000 lifetime exemption... but we will discuss these later.



Case study

When you do change a structure it is important you have not thrown away the Small Business CGT Concessions. I know it is not a part of the restructure we are considering, but ask yourself how will the new structure you are proposing after the restructure have significant individuals?

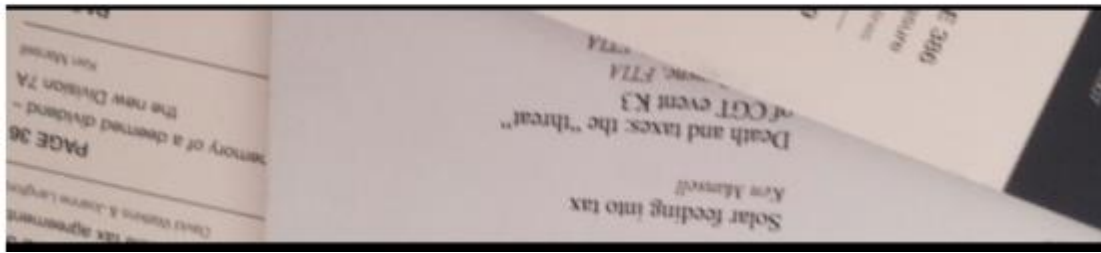
4.4 Can we use the 15-year exemption to achieve the rollover?

The 15-year exemption means:

- The entire capital gain is disregarded;
- Current and carried forward capital losses are not affected. They may be offset against other capital gains or carried forward to future years;
- If a company or trust obtains the 15-year exemption the exempt capital gain can be paid by the company or trust to its shareholders, unit holders or beneficiaries tax free.;
- If the 15-year exemption applies, the full proceeds from the relevant CGT event can be paid into super (subject to the cap discussed below). This differs from the \$500,000 lifetime concession as only the gain sheltered by the retirement concession can be paid into super.

The conditions for the 15-year exemption to apply include:

- The taxpayer continuously owned the CGT asset for the 15 year period ending just before the CGT event (or significant individual existed for 15 years if the taxpayer is a company or a trust – remember that for a discretionary trust, the trust is taken to have a significant individual in the years where no distributions of income or capital are made);
- The taxpayer (if it is an individual), or a significant individual (if the taxpayer is a company or a trust) must be 55 or over at the time of the CGT event and the event happens in connection with the taxpayer's (or significant individual's) retirement or permanently incapacitated



NOTE: There are exceptions to the 15-year continuous ownership condition if the CGT asset has been acquired as a result of rollover relief due to the compulsory acquisition, loss or destruction of another asset or marriage breakdown.

Where the 15-year exemption applies to a company or a trust, that company or trust can pay the exempt amount directly to a shareholder or beneficiary in a tax-free manner. For this to happen:

- The payment is made to an individual who was a CGT concession stakeholder of the company or trust just before the event;
- The payment is made within two years after the CGT event (you can ask the Commissioner to extend this);
- The total payments made to each CGT concession stakeholder must not exceed an amount determined by multiplying the CGT concession stakeholder's control percentage by the exempt amount.

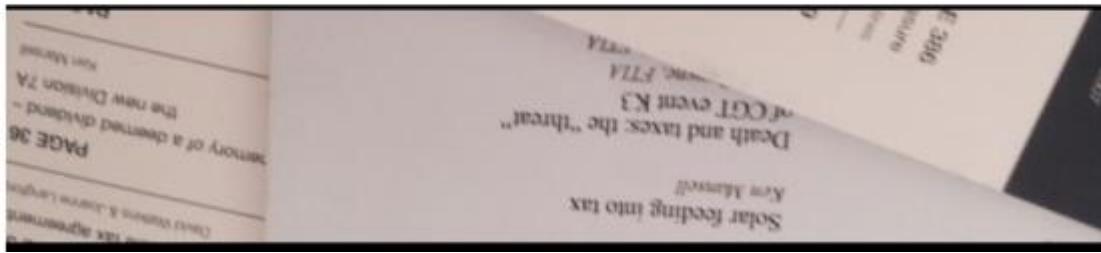
Case Study...

So what are the problems in applying the 15-year exemption to a restructure? Is it worth waiting till Chris and Vicky and the company have been owners for 15 years? Is there any way we can meet the requirement that the "event happens in connection with the taxpayer's (or significant individual's) retirement"?

Problems, so lets look at the other option... the \$500,000 lifetime concession.

4.5 Can we use the \$500,000 lifetime concession?

The \$500,000 lifetime concession allows certain CGT gains to be reduced by an individual over their lifetime, up to \$500,000. Other than passing the normal tests (active asset and either \$2M/\$10M turnover or \$6M assets) the requirements for this concession are:



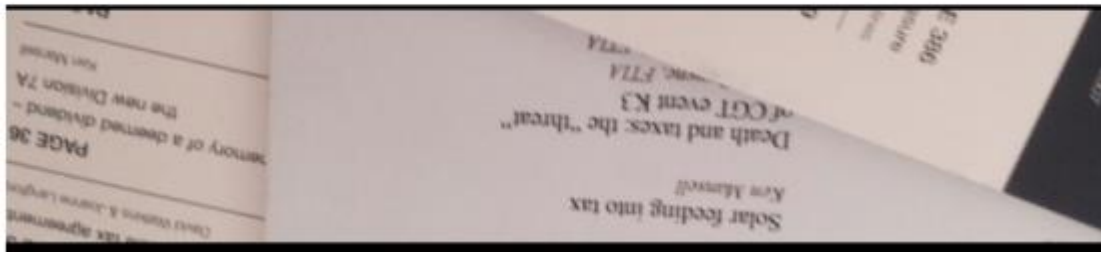
- The taxpayer must choose in writing the amount of the capital gain to be disregarded under this “retirement exemption” as it is known in the legislation. This choice must be made by the time the taxpayer lodges their tax return (even though nothing is sent to the Commissioner);
- The amount must be less than what is left of the taxpayer’s lifetime \$500,000 CGT retirement exemption limit;
- If the taxpayer is under 55 years of age at the time they make the written choice to apply the retirement exemption they must contribute an amount equal to the CGT exempt amount to a complying superannuation fund;
- The contribution must be made at the later of when the taxpayer makes the choice and when the taxpayer receives the capital proceeds from the CGT event;
- The contribution of the CGT exempt amount to a complying superannuation fund is neither deductible to the taxpayer nor assessable to the superannuation fund.
- The contribution of the CGT exempt amount to a complying superannuation fund does not count towards the concessional contributions cap or the non-concessional contributions cap.

This exemption can apply to a company or trust. For this to happen, the company or trust must satisfy the significant individual test at the time of the CGT event. And each significant individual or CGT concession stakeholder can receive up to the unused part of their \$500,000 lifetime concession.

But remember the company or trust must choose in writing how much of the capital gain is to be disregarded by the day the company or trust lodges its tax return. Also, if the company or trust has more than one CGT concession stakeholder it must specify in writing the percentage of the CGT amount that it attributed to each of those stakeholders.

The timing for a company or trust is that they must make the payments to its CGT concession stakeholders by the later of:

- 7 days after it makes the written choice; and
- 7 days after it receives an amount of capital proceeds from the CGT event.



But also remember, if a CGT concession stakeholder is under 55 at the time the company or trust makes a payment in relation to them, the company must contribute the amount to a complying superannuation

Case Study...

Looking at the restructure you proposed in section 3, is it possible to do this without paying any capital gains tax by, rather than using the small business rollover, using the \$500,000 lifetime concession that both Chris and Vicky have? Make sure you work out how you are going to get the cash to buy the asset in the new entity and how you will get this amount into super.

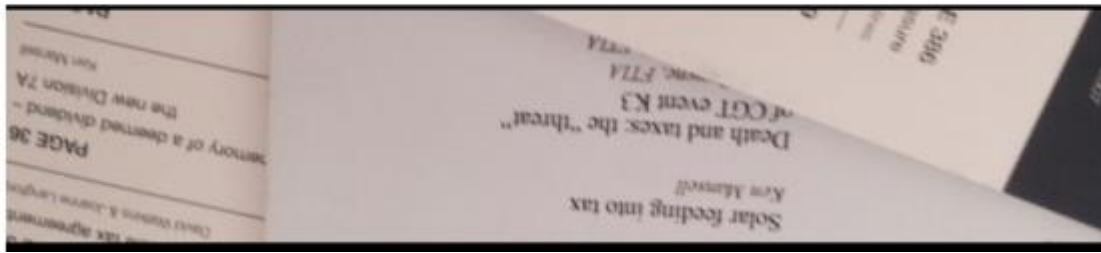
If this all gets too hard, what about this...

If the Chris and Vicky establish a new discretionary trust, lend the trust \$600,000 (which they borrow from the bank) and the trust purchases the land and building off the company, the company has a \$350,000 capital gain (cost base of \$250,000).

Assuming the basic tests for the small business CGT concession have been met (which it is clear they have), the company could opt not to apply the small business restructure rollover, but rather apply the \$500,000 lifetime concession.

The company would pay no CGT but would be required to pay \$175,000 to Chris and the same to Vicky. Given their age this amount has to be put into super, so the super fund now has an additional \$350,000.

The company still holds \$250,000 of the \$600,000 paid to it by the trust. It could pay this out as a dividend and, after top up tax is paid, Chris and Vicky could contribute this as concessional contributions over the next few years.



4.6 The mechanics of getting these the amounts into super

The main benefit that the small business CGT concessions provide for restructuring over the small business restructure rollover is the additional super contributions.

This is especially the case from 1 July 2017 as there will be many people who have substantial super balances greater than \$1.6 million won't be able to make any concessional contributions.

Regarding the 15-year exemption, a distribution of an exempt amount under the small business 15-year exemptions is not limited by the superannuation rules, unlike the retirement exemption. There is, however, a concession in the superannuation contribution rules that allows up to \$1.4 million for 2016-17 year of a capital gain that has been subject to the 15-year exemption to be paid into a super fund for the benefit of a CGT concession stakeholder. This cap is separate from the yearly concessional and non-concessional contribution limits for an individual. Given the recent changes to super contribution limits, this is an opportunity that should always be considered.

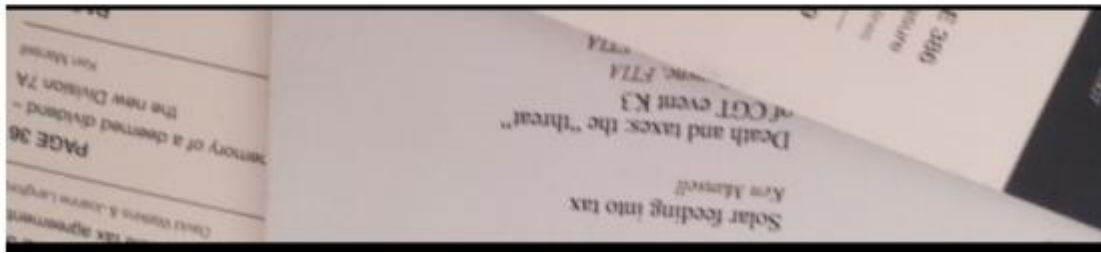
In relation to the \$500,000 lifetime concession, if the relevant individual is under 55 years of age at the time of the choice, that part of the capital gain to which the retirement exemption applies must be rolled over into a superannuation fund and preserved until a condition of release is met.

The contribution must be made at the later of when the taxpayer makes the choice to apply the \$500,000 lifetime concession and when the taxpayer receives the capital proceeds from the CGT event.

The contribution of the CGT exempt amount to the superannuation fund is neither deductible to the taxpayer nor assessable to the superannuation fund. It does not count towards the concessional contributions cap or the non-concessional contributions cap. However, it goes towards the \$1.4 million for 2016-17 year CGT cap amount in section 292-100 as discussed above.

Timing for making super contributions under the 15-year exemption and the \$500,000 lifetime concession can be tricky.

For the 15 year concession the rule is generally the individual receiving the amount has 30 days to transfer the amount into super. However, if it is the individual who is claiming the 15-year exemption, this can be delayed until the individual lodges the return in which they claim the exemption. And if it is a trust or a company claiming



the concession, remember from earlier the trust or company must pay the amount to the CGT concession stakeholder within two years of the CGT event. So after the CGT Concession stakeholder receives the amount they have 30 days to put it into super.

Regarding the \$500,000 lifetime concession:

- If an individual made the capital gain and they are under 55 when the choice is made, they must make the payment to the fund by the later of the receipt of the amounts or when the return is lodged.
- If a company or trust made the capital gain and the CGT concession stakeholder they are going to send the exempt amount to are under 55 when the choice is made, the company or trust must pay the amount to the super fund of the CGT concession stakeholder by the later of 7 days after receipt or 7 days after the trust or company return is lodged.
- If an individual or the CGT concession stakeholder of a company or trust is 55+ when the choice is made, they must make the OPTIONAL payment to the fund by the later of 30 days after the receipt of the amounts or when the return is lodged if they are claiming the concession in their return. But remember these amounts do not have to go to super!

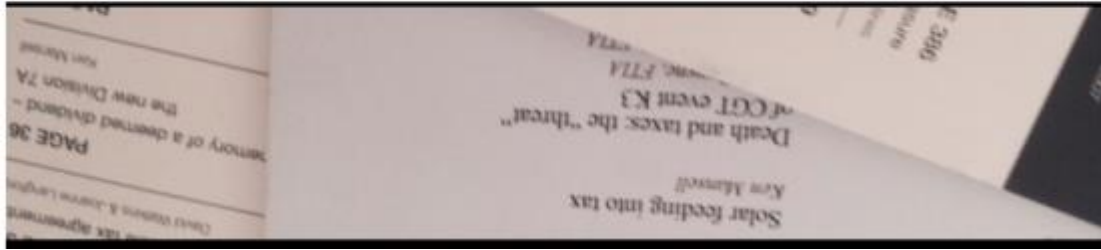
4.7 What if I am about to no longer be a small business?

The only reason other than super that may make you elect to use the small business CGT concessions rather than the small business restructure rollover is if you are getting so large you are about to lose the small business CGT concessions.

For example, you might decide to do this if you have greater than \$6 million maximum net assets and this will be the last year turnover is less than \$2/\$10 million.

You would do this to get the cost base uplift and any money that goes out to significant individuals under the \$500,000 lifetime exemption would probably just be used to pay of any borrowings that were used in the restructure.

But this is not the situation in our case study.



5. So which one would you use and why? What advice would you give Chris and Vicky?

Case Study

Are you going to recommend the small business restructure rollover or the small business CGT concessions putting additional amounts into super?