

**Mark Ratcliff**

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# SMALL BUSINESS CGT CONCESSIONS – RETIREMENT EXEMPTION

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The Small business tax concessions are a specific part of the income tax legislation which allows Australian resident tax payers which incur a capital gains liability from the disposal of a small business various forms of capital gains relief. There are 4 main small business tax concessions which include:

- 15 year exemption
- 50% active asset reduction
- Retirement exemption
- Rollover exemption

Each of these different tax concessions are only available if the appropriate eligibility questions are satisfied for each capital gain event. There are two limbs of eligibility questions that need to be satisfied, which includes the basic conditions and the specific conditions which then vary between individuals and other legal entities. These conditions are outlined below.

## Basic conditions

The basic conditions that each taxpayer must satisfy in order to access the small business tax concessions are described in s152-A of Income Tax Assessment Act (ITAA) 1997 and include:

- The entity must be a small business entity as per s328-110 of ITAA 1997 – more specifically:
  - There was a business that was trading; and
  - The aggregated turnover for this business was less than \$2 million and the net value of the assets of the entity and associated entities is less than \$6 million

- The capital gain tax (CGT) asset which was sold was an active asset – meaning that the asset was owned and used by the entity claiming the small business tax concession; and
- If the asset is a share or interest in a trust, a CGT concession stakeholder exists prior to the CGT event and subsequent claim of small business CGT relief, meaning that there was at least one individual which controlled more than 20% of the entity or if 90% or more of the entity has small business participation.

## Individuals – specific conditions

If the small business tax concessions are being claimed by an individual, then the following specific conditions apply, which include:

- The basic conditions for small business relief are satisfied
- A choice to disregard the capital gain (i.e. the CGT exempt amount) has been specified in writing by the day the individual lodges their tax return for the year of the CGT event (or longer as permitted by the Commissioner),
- Just before the choice is made by the individual, if they are under age 55, the individual must contribute an amount equal to the CGT exempt amount to a super fund at the later of when they made the choice or receipt of the capital proceeds. If the individual is age 55 or over the payment may be received directly.

## Non-Individuals – specific conditions

If the small business tax concessions are being claimed by an entity – either a company or a trust – the different specific conditions apply, which include:

- The basic conditions for small business relief are satisfied;
- A choice to disregard the capital gain (i.e. the CGT exempt

amount) has been specified in writing by the day the company or trust lodges their tax return for the year of the CGT event (or longer as permitted by the Commissioner), and

- The company or trust has made payment to at least one of its CGT concession stakeholders by the later of seven days after it makes the choice, or seven days after receipt of capital proceeds, and
- Just before the payment is made by the company or trust, if the recipient is under age 55, the company or trust must contribute an amount equal to the CGT exempt amount to a super fund at the later of when they made the choice or receipt of the capital proceeds. If the individual is age 55 or over the payment may be received directly.
- Choosing the retirement exemption for a capital gain (subject to the \$500,000 limit) without first applying the 50% active asset reduction might allow a company or trust to make larger tax-free payments to the CGT concession stakeholders of the company or trust.

Where there is more than one CGT concession stakeholder, the company or trust must specify in writing the percentage of each CGT asset's CGT exempt amount that is attributable to each stakeholder. One specified percentage may be nil, but they must add up to 100%.

The CGT exempt amount cannot exceed \$500,000 per individual (the lifetime limit per individual (s152-320)). This means that where a company or a trust has eight CGT concession stakeholders, it is possible to apply to retirement exemption to exempt \$4 million (\$500,000 for each stakeholder). Any capital gain that exceeds this limit does not qualify for this exemption (ss152-310 (1)).

The most important condition to keep in mind when claiming the small business tax concessions from an entity – either a company or a trust – is that there exists the requirement for the funds to be paid from the entity, as to ensure that the conditions are satisfied and the concessions will apply.

## Available small business tax concessions

As outlined above, there are four separate small business tax concessions that are available which include:

- Small Business 15 Year Exemption;
- Small Business 50% Active Asset Reduction;
- Small Business Retirement Exemption; and
- Small Business Rollover

Each of these separate instances are described in further detail later.

### Small business 15 year Exemption

This particular exemption is the most generous available, allowing the capital gain made to be completely disregarded. There is no need to apply other concessions as the total of the capital gain amount is reduced to zero. Further to that, this concession does not require any carried forward capital losses to be utilized prior to the application of this exemption.

If this concession is being claimed by an individual, the specific conditions to meet these criteria are that the small business CGT concessions have been met for the last 15 years and that ownership was consistent during this time. This concession is only available to individuals that are aged 55 or over, or who are permanently incapacitated. If the CGT asset which was sold was a share in a company or an interest in a trust structure, the small business is required to have at least one significant individual for the entire period.

If a company or trust is claiming this exemption, there needs to have been at least one consistent significant individual for the entire period and for the individual who is the significant individual prior to the sale was at least 55 and retiring or permanently incapacitated.

### Small business 50% active asset reduction

This exemption is the next exemption that is normally applied after the 15 year retirement exemption – if it is not able to be applied for maximum benefit. It is important to realize that with this exemption, there are no specific tests or criteria which will apply – satisfying the basic conditions will be enough. This exemption can be highly beneficial for individuals and trusts, as when combined with the standard capital gains concessions (holding an asset for more than 12 months) the capital gain can be reduced to 25% of the original value of the capital gain amount.

### Small business retirement exemption

The small business retirement exemption allows a taxpayer to disregard the entire amount of a taxable capital gain if the conditions are satisfied. This exemption does not require the individual who receives it to terminate any activity or cease business. If the individual is acting as a stakeholder, there is no need for that individual to cease employment with the entity that you are disposing of.

To be eligible to claim this exemption, the individual must satisfy the basic conditions, keep appropriate written records of the amounts which are to be disregarded and, if under 55 at the time directly prior to making the choice to use this exemption, the individual makes a personal contribution to a complying superannuation fund. It is important to remember that an individual is not required to contribute to a superannuation fund until directly prior to making the choice to apply this exemption.



#### The quote

*There is no need to apply other concessions as the total of the capital gain amount is reduced to zero.*

**The quote**

*If the sale of an asset qualifies for the retirement exemption, the owner has the option of contributing all or some of the exempted capital gain to a regulated Australian superannuation fund.*

**Small business rollover**

The small business rollover exemption allows a taxpayer to disregard any capital gain amount from the sale of an active asset. There are specific conditions which are applied to this exemption which include:

- The acquisition of a replacement asset within two years of disposing of the initial asset;
- The asset which has undertaken capital improvements is an active asset at the end of the replacement asset period;
- The capital gain being used for the rollover is not higher than the cost of the replacement asset or any part of the incidentals or capital improvement amounts.

If all of these conditions are not satisfied by the end of the replacement asset period then the capital gain will be applied in full at the end of the two year period.

It is important to understand that this gain will be assessable when the asset which is used as the replacement asset is disposed of. Any capital gain on the disposal of the second asset is added to the original capital gain amount. There is the ability to apply other small business tax concessions at this time, if they are applicable.

**CGT exempt amount and limits**

If the sale of an asset qualifies for the retirement exemption, the owner has the option of contributing all or some of the exempted capital gain to a regulated Australian superannuation fund. The capital gain that is permitted to be exempt from capital gains tax is limited to a lifetime contribution limit of \$500,000.

The amount of the capital gain (maximum of \$500,000) that is contributed to superannuation will not be treated as either a concessional or non-concessional contribution if the contribution counts towards and does not exceed the person's lifetime CGT cap, (which is currently \$1.255 million for 2012/13 and indexed annually).

The individual must meet the work test to contribute the amount to superannuation if they are between age 65 and 75. From age 75, an individual is not permitted to make personal or voluntary employer contributions to superannuation and therefore may not contribute the sale proceeds to a superannuation fund.

**Is retirement required?**

The naming of the small business retirement exemption is slightly misleading. This is because regardless of whether the taxpayer wanting to utilise the small business retirement exemption is an individual, or a company or a trust making a payment to a CGT concession stakeholder, there is no requirement that the individual /CGT concession stakeholder must retire in order for the taxpayer to utilise the small business retirement exemption, unless the 15 year retirement exemption is utilized. In this instance, retirement must be satisfied to ensure that the concessions can be applied appropriately. **FS**