TAX TALKS

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166 | Small Business CGT Concession Case Studies

Here are 5 small business CGT concession case studies to make it easier to get a grasp of the concepts (and loopholes that still exist).

Small Business CGT Concession Case Studies

To make the small business CGT concessions less confusing and to show you some of the peculiar features of these concessions, Andrew Henshaw of Velocity Legal will walk you through 5 small business CGT concession case studies.

Here is what we learned but please listen to this episode of Tax Talks as Andrew explains all this much better than we ever could.

To listen while you drive, walk or work, just access the episode through a podcast app on your mobile phone.

Case Study # 1 – $6m Net Asset Value Test

This first case study is fairly simple. But it really emphasizes that the small business CGT concessions is about all or nothing. If you have net assets of 5,999,999.99 you qualify. And if your net assets are 6,000,000.01, then you don't.

If your business is worth 5.9 million with a cost base of nil, then you pay about $1.38m on the capital gain assuming that you have got the 50% CGT discount. In contrast if you qualify for the small business CGT concessions, you might pay zero tax. So the small business CGT concessions can make a huge difference.

Richard

So let's look at the example of Richard. Richard is about to sell his successful business for $5.9m. The business has a turnover of well over $2m, so Richard's only chance is the net asset value test.

Richard owns his $3m family home, a $1.5m holiday house, $2.5m in super and $300k in the bank but nothing else. The main residence, assets held for personal use and enjoyment as well as super are not included in the net asset value test, so the only other asset we need to worry about is Richard's bank balance.

Can Richard claim the Small Business CGT Concessions on the sale of his business?

Answer

And the answer is No, since his net asset value is $5.9m + $0.3m cash = $6.2m. The family home, holiday house and super don't count in this test. So Richard is over the $6m minimum net asset value test and will potentially pay $1,386,500 in tax.

Capital proceeds of $5.9m
Less a zero cost base
Less 50% CGT Discount
Tax at. 47% top marginal rate
Equals $1.3865m tax

However, if Richard spends the $300k cash and goes on a holiday, renovates his house or buys a Ferrari, then his net assets go down to $5.9m. So he qualifies for the small business CGT concessions and potentially pays zero tax. This example is probably the only scenario where buying a Ferrari would save you a million dollars.

Case Study # 2 – Active Asset Test

This case study illustrates the huge back door we had under the previous rules. And how this door is now closed – at least for asset and unit sales.

Bill – Company

Bill, 56, is a billionaire and owns 39.9% of Bill Co, a company worth $10 billion, and has owned these shares for well over 15 years. Under a takeover offer, Bill is offered $3.99 billion for his shares, which he accepts.

Bill is an enthusiastic chef, retires from the mining game and starts a small restaurant in Parramatta in the same year with a turnover of less than $2m.

Bill Co owns a large $7b coal mine in WA, a wholly owned subsidiary that owns a small gold mine worth $800 million and gold bullion of $200 million which is held as an investment asset and a portfolio of shares in other mining companies of between 1% and 10%, worth $2 billion.

Can Bill claim the small business CGT concessions?

Before 8 February 2018

Before 8 February 2018, he could. The restaurant has a turnover of less than $2m, so Bill passes the small business turnover test and potentially saves $937,650,000 in tax.

Under the old law, he could have even started the restaurant even after the sale. If Bill had sold the shares on Bill Co on 1 August, then spoke to his account and then started the restaurant on 1 January after the sale, he would still have qualified as a small business.

After 8 February 2018

But after 8 February 2018, the game has changed and he can't. Bill Co now needs to pass either the net asset value test or the $2m turnover test. It fails the turnover test, so the net asset value test is its only chance. To pass the net asset value test it must pass the modified active asset test.

The share portfolio no longer counts as active assets, taking its active asset percentage down to 78%, failing the modified active asset test. So Bill Co fails and Bill no longer qualifies for the small business CGT concessions and has to pay tax on his capital gain.

But the new changes are limited to the sale of shares and units. If you slightly alter those facts in the case of Bill the billionaire, and make him to own land instead of shares, things change big time. If Bill ran a business – possibly many years ago – or still runs a business on that land, then the door springs wide open again to access the small business CGT concessions.

So this is what case study# 3 is about.

Case Study # 3 – Loophole Remains

If we stay with Bill. there is still a loophole as long as there are no shares or units. The new integrity measures are only in relation to shares or units.

Bill – Gold Course

Let's say rather than holding the shares in a company, Bill personally owns a hugely popular $1b golf course that he bought decades ago.

Bill is still operating his restaurant in Parramatta. Its turnover for the past 5 years has been a miraculously steady $1.9 million each year.

Bill closes the golf course for renovations and so only has the turnover of his small restaurant. At the end of the renovations, he sells the golf course. He fails the minimum net asset value test but that doesn't matter. He is still eligible for the small business CGT concessions since his turnover is below $2m.

The land of the golf course is an active asset because Bill has run a business on the land for over 7.5 years. So even if the golf course is no longer operating, the land would still qualify as an active asset since it once was.

Bill fails the net asset value test since his land holdings are worth a lot more than $6m.

Case Study # 4 – Restructure

Tom, Dick and Harry are equal unit holders in the $15m TDH Unit Trust, which operates an engineering business, but don't have any other assets. They are worried about negligence claims and creditor protection for their plant & equipment and so consider a restructure or future sale, aiming to minimise future capital gains and minimise tax.

Tom, Dick and Harry would each have an net asset value position of 5 million dollars. Under the old rules they wouldn't have had to include the value of the unit trust because they each have less than 40% and hence would have passed the net asset value test. But now under the new rules they need to test the unit trust itself since selling units.

Does the unit trust have a net asset of less than 6 million dollars?

Answer

With a net value of 15 million it clearly doesn't and so fails this separate test.

Remember that these new provisions apply only to sales of shares or units. So if you have the exact same circumstances but instead of being a unit trust you have a partnership, then Tom Dick and Harry as one-third partners in a partnership worth 15 million dollars would still qualify for the small business CGT concessions.

The concession can be used for a restructure. To lock in a currently available CGT concession. There are various restructure rollovers. But another way of doing it is by the small business CGT concessions.

Case Study # 5 – Active Asset Test

Case study # 5 looks at the active asset test, in particularly in relation to land used for different purposes.

Mr and Mrs Smith

Mr and Mrs Smith jointly own a 10-hectare property they purchased in 1986 just after the introduction of CGT. It was purchased as their family home. Now it is in a urban growth zone and has been rezoned for development. Developers offered 15 million dollars to but this land.

The Smith's are builders and they conduct a business that has a $1.9m turnover. They run their business from another site but they store their work truck equipment and building supplies in a shed on the property.

To see whether the Smiths can claim the small business CGT concessions, the main question is whether the land is an active asset. The land has been used as a family home but there has been some business related activity on part of the property – large shed on the property.

An active asset is an asset that you own or use or hold ready for use in the cause of carrying on a business. And the business needs to be carried on by you or someone connected.

Legislation

The legislation in s 152-40 ITAA97 just says 'use'. It doesn't say 'predominantly used' or 'significantly used' or 'majority used or 'substantially used'. It does not qualify use.

> *s152-40 (1) ITAA 97 – "A CGT asset is an active asset at a time if, at that time you own the asset (whether the asset is tangible or intangible) and it is used, or held ready for use, in the course of carrying on a business that is carried on (whether alone or in partnership) by you, your affiliate, or another entity that is connected with you."*
>
> *s152-40 (4) (e) ITAA97 – "An asset cannot be an active asset if its main use is to derive interest, an annuity, rent, royalties or foreign exchange gains."*
>
> *s152-40 (4A) (a) – "In determining the main use, any personal use of the asset is disregarded."*

Subdivision

If you subdivide the property, that would change things because then you would have separate assets that might be quite different to each other.

Small Business CGT Concession Case Studies

So these were 5 small business CGT concession case studies about 5 major concepts you need to understand. But please listen to this podcast episode as well. It will make things a lot clearer.

MORE

[Engagement Letters]

[The 4 Small Business CGT Concessions]

[Small Business CGT Concessions for Big Business]

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