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35 | Improving the Small Business CGT Concessions ED

“Improving the Small Business CGT Concessions” is the title of the new exposure draft that the ATO issued on 8 February 2018. It is a response to the changes proposed in the 2017/18 budget. All this could spell trouble. Adding still more complexity to claiming the small business CGT concessions.

Improving the Small Business CGT Concessions ED

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At the start it sounded all so simple. The four small business CGT concessions

15-year exemption (Subdivision 152-B of ITAA 1997)
50% Reduction (Subdivision 152-C of ITAA 1997)
Retirement exemption (Subdivision 152-D of ITAA 1997)
Rollover concession (Subdivision 152-E of ITAA 1997),

allow business owners to sell their business and reduce or eliminate their capital-gains tax. There must be a CGT event involving an active asset resulting in a capital gain. The taxpayer must either pass the turnover test or the maximum net asset value test. And if the CGT asset is a share or interest in a trust there also needs to be a significant individual and concession stakeholder with a small business participation percentage of at least 20%.

This is a short summary of the small business CGT concessions in four sentences. I agree that it is not that simple. That there is a lot more devil in the detail. But this is basically what we got at the moment.

Improving the Small Business CGT Concessions ED

But now come the reforms proposed in the 2017/18 budget, released as an exposure draft on 8 February 2018 with the consultation period having closed on 28 February 2018. The aim of this ED is “improving the small business CGT concessions”. Whether it achieves this or just complicates the whole exercise remains to be seen.

The ED’s stated policy aim is to “prevent taxpayers from accessing the concession for assets unrelated to their small business such as arranging affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.” This aim to introduce an integrity measure is done via five new tests and requirements.

Modified Active Asset Test

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Cash and financial instruments are no longer considered to be an active asset unless they are trading stock. Instead, the approach is to look through shares or interests in trusts to the underlying assets behind the shares or interests. The value of these underlying assets is multiplied by the *small business participation percentage* of those assets. This is is a stricter test since this percentage might be zero . All this makes it harder to meet the modified active asset test.

Object Entity Included

The object entity itself is now subject to the $2m turnover or minimum net asset value test. It is no longer enough if the connected entity using the asset passes these tests.

Lower Connected Entity Threshold

The connected entity threshold is currently 40%. The proposed reforms reduce this to 20%. So the minimum net asset value test would include the CGT assets and turnovers of the object entity, affiliates and 20 % connected entities. So this makes it much much harder to satisfy the $2m turnover test or MNAV test.

Object Entity Must Carry on a Business

The connected entity itself must now carry on a business.

Taxpayer Must Carry on a Business

The taxpayer itself must carry on business just before the CGT event if taxpayer doesn't satisfy MNVAT.

These rules are to apply retrospectively from 1 July 2017. If this doesn't change, it will catch many off-guard.

The new proposals will add a significant compliance burden and complexity to claiming a small business CGT concession. The rules go beyond what the integrity measures intended.

The public consultation period closed on 28 February 2018. But the government hasn't issued a response yet to any submissions at the time of writing. So this is still in the pipeline for now.

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