

MARCH 2018

TECHNICAL UPDATE

SMALL BUSINESS CGT CONCESSION CONSULTATION

THE GOVERNMENT IS PROPOSING TO TIGHTEN THE ELIGIBILITY FACTORS FOR THE CGT CONCESSIONS THAT ARE GENERALLY AVAILABLE TO SMALL BUSINESSES AND DENY ELIGIBILITY FOR ASSETS UNRELATED TO THE SMALL BUSINESS EFFECTIVE FROM 1 JULY 2017. BDO'S SUBMISSION ADVOCATES FOR EITHER THE MEASURES TO BE BETTER TARGETED OR FOR THE GOVERNMENT TO JUSTIFY THE REDUCTION IN SCOPE OF THE CONCESSIONS.

NEW LAW

On 8 February 2018 the Government released [exposure draft legislation and explanatory material](#) for public consultation on integrity improvements to the small business capital gains tax (SBCGT) concessions. The reforms were first announced in the 2017/18 Federal Budget, as part of a 'tax integrity' package of reforms to apply from 1 July 2017.

The Budget announcement for this integrity rule said it was designed to prevent taxpayers from accessing the SBCGT concessions for assets which are unrelated to their small business, such as by arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions. However, the changes proposed in the Exposure Draft go further than the budget announcement. The Government is now proposing that the SBCGT concessions are only to be accessed in relation to active assets used in a small business, or for ownership interests in a small business. The increase in scope of these changes means that if they are to apply from 1 July 2017, they would be retrospective amendments in relation to the increased scope amendments.

CHANGES

Under the current law, small business taxpayers can access certain concessions which provide them with various relief on capital gains derived on CGT assets that are used in their business. The concessions are in place as an alternative for superannuation to allow small business taxpayers to keep their retirement savings as investments in their small businesses and to allow these small businesses to further grow. Currently, it is the view of Government that some taxpayers are accessing these concessions for assets which are not related to the taxpayer's small business. Further, it is believed that some taxpayers are 'arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions'.

SECTOR

Tax

STEVE FIMMANO

Partner, Adelaide

+61 8 7324 6046

steve.fimmano@bdo.com.au

MARK MOLESWORTH

Partner, Brisbane

+61 7 3237 5848

mark.molesworth@bdo.com.au

ERIC OLUFSON

Partner, Cairns

+61 7 4046 0047

eric.olufson@bdo.com.au

MAL SCIACCA

Partner, Darwin

+61 8 8981 7066

mal.sciacca@bdo.com.au

BRETT SKIRVING

Partner, Hobart

+61 3 6234 2499

brett.skirving@bdo.com.au

JASON DE BOER

Partner, Melbourne

+61 3 9603 1781

jason.deboer@bdo.com.au

MARK POLLOCK

Partner, Perth

+61 8 6382 4794

mark.pollock@bdo.com.au

MARCUS LEONARD

Partner, Sydney

+61 2 9240 9771

marcus.leonard@bdo.com.au

The proposed amendments broadly include three additional 'basic conditions' to be satisfied for a taxpayer to apply the SBCGT concessions to a capital gain arising in relation to a share in a company or an interest in a trust. These conditions are:

- ▶ A requirement for the vendor to be carrying on a business, where the \$6 million 'maximum net asset value' test is not satisfied
- ▶ Additional small business conditions relating to the company or trust, including that it be carrying on a business just before the relevant CGT event for the shares or units, and either it is a 'small business entity' for the relevant income year or it satisfies the AUD \$6 million 'maximum net asset value' test, and
- ▶ The 'active asset' test that looks through shares in companies and interests in trusts to the activities and assets of the underlying entities will be modified to restrict the situations where financial instruments and cash can be included in the active asset test.

Importantly, there is also a modified 'control test' where the CGT event is a share in a company or interest in a trust. This modified control test is based on a 20 per cent threshold instead of the current 40 per cent threshold (the 40 per cent threshold remains for other purposes). This will mean that more entities will be 'connected with' one another for the purpose of the revised rules, and therefore the assets and turnover of more entities may need to be taken into account when determining if the qualifying small business thresholds have been met when the CGT event is in relation to share in a company or interests in a trust.

ISSUES WITH THE NEW LAW

BDO are of the view that the proposed provisions will significantly reduce the circumstances in which taxpayers can claim the SBCGT concessions. While these are badged as integrity measures, the proposed law does more than just limit abusive arrangements — it removes the concessions from 'plain vanilla' circumstances that were clearly meant to be captured by the existing provisions.

The drastic increase in scope, which was not flagged in the 2017/18 Federal Budget announcement, means that the proposed provisions are in some respects retrospective and will adversely affect taxpayers who have sold shares in companies or interests in trusts since 1 July 2017 in reliance on the existing law and the plain meaning of the budget announcement. Either the legislation needs to be better targeted, or the Government needs to justify the reduction in scope of the concessions.

BDO SUBMISSION

On 28 February 2018 BDO lodged a submission, available [here](#) on the BDO website, in response to SBCGT concessions exposure draft legislation, which contains the following recommendations:

The legislation needs to be better targeted, or the Government needs to justify the reduction in scope of the concessions.

BDO believe that the proposed provisions will significantly reduce the circumstances in which taxpayers can claim the SBCGT concessions. While they are being badged as integrity measures, the proposed law does more than just limit abusive arrangements — it removes the concessions from 'plain vanilla' circumstances that were clearly meant to be captured by the existing provisions. The proposed changes also specifically undo the benefits of the small business concessions package introduced in 2007 by changing the additional basic conditions for shares in companies or interests in trusts in section 152-10 ITAA 1997 that change the controlling entity test from 40 percent to 20 percent.

BDO have prepared examples of situations where previously eligible small businesses would now be ineligible for the concessions:

- ▶ A mother, father and daughter each own one-third of the shares in ABC Pty Ltd. ABC runs an engineering business turning over \$8 million per year. All three agree to sell their shares for a total of \$7 million (i.e. \$2.3 million each).
- ▶ The XYZ Unit Trust is 100 percent owned by Jenny. The XYZ Unit Trust owns a small commercial tenancy which is leased to Why Pty Ltd. Jenny also owns 100 percent of the shares in Why Pty Ltd. The XYZ Unit Trust is not considered to carry on a business because its leasing activities are small scale. Jenny sells all of the shares in XYZ Unit Trust and all of the shares in Why Pty Ltd for a total of \$1 million. The existing concessions would apply to the entire transaction. Under the proposed law, the concessions would be available for the sale of the shares, but not the sale of the units.

The proposed changes should not be retrospective in nature

If these measures are to all apply retrospectively, this means that taxpayers may have a significantly larger than expected tax bill where CGT assets have been sold after 30 June 2017, and the existing SBCGT concession rules have been applied. BDO has recommended that the changes apply from 1 July 2018 to provide small businesses with time to prepare.

The Object Entity to meet the MNAVt or small business entity test should be replaced with the simpler requirement

The requirement for the Object Entity to meet the maximum net asset value test (MNAVt) or small business entity test will exclude taxpayers who are presumably outside the integrity concern. Additionally, the requirement that the Object Entity be carrying on a business just prior to the relevant CGT event would prevent taxpayers from applying the SBCGT concessions to a capital distribution received upon the liquidation or winding-up of an entity; even if the shares in the Object Entity met the active asset test for the requisite period of time. Again, this would seem to be collateral damage. The requirement for the Object Entity to meet the MNAVt or small business entity test should be replaced with the simpler requirement that the relevant CGT asset have a sufficient link to the relevant small business carried on by the taxpayer.

The proposed changes should be less complex and align with the policy intent

While the draft legislation can be lauded for addressing the integrity issues head-on, it struggles to adhere to the underpinning policy of the SBCGT concessions of reducing the tax cost and compliance burden for small business. That is, the draft legislation adds a further degree of complexity to existing provisions which are already perceived as complex. Of great concern, and something which afflicts tax law amendments from time to time, is that the proposed changes will exclude many genuine small taxpayers from obtaining the SBCGT concessions in an effort to prevent the troublesome few from accessing them. BDO recommends that the proposed changes should be less complex and align with the policy intent.

BDO COMMENT

The new SBCGT concession rules are an important step in making sure that such concessions can only be accessed by taxpayers for which they were originally intended, however the rules may be too widely drafted and there are many issues that need to be addressed, some of which have been outlined in this BDO Tax Technical Update. Contact BDO for assistance with working through the provisions to determine if you satisfy the required eligibility conditions for the small business CGT concessions.

MORE INFORMATION

1300 138 991

www.bdo.com.au

NEW SOUTH WALES • NORTHERN TERRITORY • QUEENSLAND • SOUTH AUSTRALIA • TASMANIA • VICTORIA • WESTERN AUSTRALIA

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact the BDO member firms in Australia to discuss these matters in the context of your particular circumstances. BDO Australia Ltd and each BDO member firm in Australia, their partners and/or directors, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO refers to one or more of the independent member firms of BDO International Ltd, a UK company limited by guarantee. Each BDO member firm in Australia is a separate legal entity and has no liability for another entity's acts and omissions. Liability limited by a scheme approved under Professional Standards Legislation other than for the acts or omissions of financial services licensees.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2017 BDO Australia Ltd. All rights reserved.