HLB Mann Judd

Accountants | Business and Financial Advisers

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Small Business CGT Case Study
Selling Your Client's Business

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Small Business CGT Concessions – Detailed Case Study

Background – High Flyer Consulting Pty Limited

1. High Flyer Consulting Pty Limited runs a boutique business consulting business, and was established for this purpose in 2001 by the three directors Eddie Dean, Jake Chambers and Roland Deschain. Its annual turnover is currently around $4.5m.

2. High Flyer has 300 ordinary shares on issue, held as follows:

   - Eddie Family Trust (EFT) – 100 ordinary shares
   - Jake Family Trust (JFT) – 100 ordinary shares
   - Roland Family Trust (RFT) – 100 ordinary shares

3. As the shares were issued on incorporation of the company, before the business started, the three family trusts have only a nominal CGT cost base for their investment in High Flyer. For simplicity, assume that the cost base in each case is nil.

4. The directors are approached in November 2009 by a large consulting firm Gilead wanting to acquire the business for $15m, and consider this to be a very attractive offer. They have asked you to advise them on the most tax effective way for them to structure the purchase, and in particular to make the best use of any CGT concessions.

5. Eddie Dean has been a client of your firm for several years and, as well as advising the business, he has asked you to advise on the tax implications for him personally.

6. If a deal can be done, 23 December is the proposed contract date. At this date Eddie will be aged 42, Jake will be aged 35, and Roland will be aged 54

7. As the company's balance sheet is relatively clean, and both the business and the directors are well known to Gilead, the purchasers are prepared to consider acquiring either the business or the shares in the company. The entity making the purchase will be Gilead Consulting Pty Limited, a wholly owned subsidiary of Gilead Holdings Pty Limited (which meets the definition of 'non-widely held' for tax purposes).

   Note - In practice, for commercial, legal and other reasons a purchaser will often have a strong preference for an asset purchase but, as we will see below, achieving a share sale can be significantly more tax effective for the vendor.

Eddie Dean's family structure

1. Eddie's wife Susannah is aged 40, and between them they have a number of entities.

2. The Tower Property Trust (TPT) owns two commercial investment properties valued at $3m, against which it has borrowed $2.5m, i.e. net asset value of $500,000. It is a unit trust, and Susannah owns 100% of the units.

3. The Tower Equities Trust (TET) has a portfolio of listed equites ($1.5m value) and unlisted equities ($750,000 value), and loans of $2,000,000, i.e. net value $250,000. It is a discretionary trust, with Susannah as the appointor. While Eddie does not normally receive distributions, in 2007 Eddie received 70% of the distributions made.

4. Tower Investments Pty Limited has cash on deposit of $50,000, and 100% of the shares in the company are owned by the Eddie Family Trust (EFT).

5. As noted above, EFT owns one-third of the shares in High Flyer. Eddie is the appointor of EFT, and receives a majority of the distributions made each year.

6. Eddie and Susannah jointly own an investment property valued at $1m, debt-free. They also jointly own the family home valued at $3.5m, and each have a balance of approximately $1.5m in the Tower Superannuation Fund.

7. In his own right, Eddie has a portfolio of listed equities valued at $250,000, and has a related loan with a balance owing of $150,000.

8. Susannah has a managed fund portfolio valued at $1m, and has lent $100,000 interest-free to her sister Odetta, repayable in five years time.

Roland Deschain's family structure

1. Roland's wife Ruby is aged 56, and has no investment assets in her own right. Ruby owns the family home which is valued at $2.5m.

2. Roland is the appointor of the Roland Family Trust (RFT), and has received 60% of the distributions in each of the last four years.

3. Roland has cash deposits of $2m, being proceeds from the estate of his father Stephen.

Structuring issues – asset sale vs share sale

1. As a general rule selling the shares in a company will be more tax-effective for the ultimate owners of the business than an asset sale by the company.

2. The first reason for this is because individuals making a capital gain either directly or indirectly as a beneficiary of a trust will receive the 50% CGT discount as long as the shares have been held for at least 12 months, i.e. a maximum tax rate of 23.25%.

3. As companies do not receive the CGT discount, a capital gain on selling the business assets would be taxed to the company at 30%. Further, when the company later pays out the capital profit as a dividend to its shareholder, further 'top-up' tax will be paid where the individual's marginal tax rate exceeds 30%.

4. As illustrated below, the difference can become even greater when some or all of the small business CGT concessions are available. A key problem with accessing concessions within a company is that the benefits can sometimes be lost when the capital profits are eventually paid out to the shareholders.

5. Firstly, the method of the sale can mean the difference between passing or failing the threshold $6m net asset value (NAV) test. The test is applied to the entity selling the assets, as well as any connected entities and affiliates.

6. If High Flyer sells its business goodwill for $15m, if follows that the company's NAV must exceed $6m and it will fail the NAV test. As its turnover is also well over $2m, it is clear that High Flyer would be unable to access any of the small business concessions.

7. By contrast, if each of the family trusts sell their shares in High Flyer then:

   - The trusts and their beneficiaries will claim the 50% CGT discount;

   - The trusts and any connected entities will be able to apply the NAV test individually, and will stand a much better chance of being able to access some or all of the small business CGT concessions; and

   - Each family will avoid the "tax leakage" that often arises when a company sells assets, uses the small business CGT concessions and then pays the capital profits out to its shareholders as franked and/or unfranked dividends.

8. Depending on the State or Territory in which the business is located, stamp duty might arise on a business sale. While stamp duty is also payable on share transfers in some States, as long as the company is not land-rich then the rate of duty is generally considerably lower than for a business sale (e.g. 0.6% in NSW).

Analysis – tax implications of an asset sale by High Flyer

1. The first step is to determine whether High Flyer satisfies the basic conditions for claiming the small business CGT concessions on the sale of goodwill.

    - *Small Business Entity (SBE) test – did High Flyer carry on a business during the year, and is the aggregated turnover of High Flyer, including turnover of its connected entities and affiliates, $2m or less?*

      No, while High Flyer did carry on a business during the year, its annual turnover alone is $4.5m, so the SBE test is failed.

    - *Net Asset Value (NAV) test – does High Flyer, together with its connected entities and affiliates, have a NAV of $6m or less?*

      No, as High Flyer's business (represented by goodwill) is valued at $15m, the NAV has clearly been breached even before considering other entities.

    - *Active asset test – does the capital gain arise from selling an active asset?*

      Yes, the sale of goodwill satisfies the active asset test.

2. In this case, while High Flyer satisfies the active asset test, it does not meet all of the basic conditions for the small business CGT concessions in subdivision 152-A, because it does not satisfy either the SBE test or the NAV test.

3. This means that, as set out on below for scenario 1, High Flyer would pay tax at the rate of 30% on the capital gain of $15m in its 2010 tax return, i.e. $4.5m, and would be left with retained profits after tax of $10.5m at 30 June 2010.

High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 1
No concessions available

Sell business assets

Tax payable by companies on sale of assets

Sale proceeds	15,000,000
Less - CGT cost base (assumed nil)	-
Gross capital gain	15,000,000
Less - 50% active asset reduction	
Taxable capital gain	**15,000,000**
Tax payable at 30%	**4,500,000**

Retained profits in company

Capital profit on sale of business	15,000,000
Tax payable	(4,500,000)
Accounting profit after tax	**10,500,000**
Retained profits arising from sale	**10,500,000**
CGT Exempt Component (distribute as capital on liquidation)	**-**
	10,500,000

4. Suppose that in the 2011 year High Flyer pays a franked dividend of $3.5m to each shareholder, with a franking credit of $1.5m, i.e. $5m grossed up. As set out on the following page, assuming the top marginal tax rate of 46.5%, the individual beneficiaries of each family trust would pay "top-up tax" of $825,000, leaving net proceeds of $2.675m after tax.

5. This means that, in total, the owners of High Flyer will have paid tax of $6.975m, representing 46.5% of the gross sale proceeds of $15m. Obviously, to the extent that individual beneficiaries are on lower marginal tax rates, the overall return to shareholders could be improved. The fact remains, however, that in the absence of the small business CGT concessions a substantial amount of tax would be paid, reducing the net cash available to be returned to the shareholders.

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***
Franked dividend paid		
Franked dividend payable (on liquidation or otherwise)	10,500,000	3,500,000
Gross up for franking credit	4,500,000	1,500,000
Taxable dividend	**15,000,000**	**5,000,000**
Tax payable (assumed marginal tax rate 46.5%)		2,325,000
Less - franking credit		(1,500,000)
Net tax payable on total distributions made		**825,000**

Net received after tax by individual shareholders		
Capital profit on cancellation of shares	-	-
Franked dividend paid	10,500,000	3,500,000
Tax payable by individuals	(2,475,000)	(825,000)
Net proceeds received after tax	**8,025,000**	**2,675,000**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**-30.00%**	(4,500,000)
Tax payable by individual beneficiaries	**-16.50%**	(2,475,000)
Net proceeds received after tax	**53.50%**	**8,025,000**

Analysis – tax implications of the EFT selling its shares in High Flyer

Satisfying the basic conditions

1. The first step is to determine whether EFT satisfies the basic conditions for claiming the small business CGT concessions on the sale of its shares.

   - *Small Business Entity (SBE) test – did EFT carry on a business during the year, and is the aggregated turnover of EFT, including turnover of its connected entities and affiliates, \$2m or less?*

     No, EFT did not carry on a business at any time during the year, so it cannot satisfy the SBE test.

   - *Net Asset Value (NAV) test – does EFT, together with its connected entities and affiliates, have a NAV of \$6m or less?*

     Yes, as set out below, the NAV of EFT and its connected entities is \$5.9m.

   - *Active asset test – does the capital gain arise from selling an active asset?*

     Yes, as explained below, a review of the underlying assets shows that the shares in High Flyer would satisfy the active asset test.

   - *CGT concession stakeholder requirement – as EFT is an entity selling shares, do CGT concession stakeholders in High Flyer have together a 'small business participation percentage' in EFT of at least 90%?*

     Yes, as explained below, based on the expected trust distributions for the 2010 year EFT would satisfy the 90% requirement in respect of the share sale.

Eddie Family Trust (EFT)
Application of Net Asset Value (NAV) Test
Sale of Shares in High Flyer Consulting Pty Limited

Potential Connected Entities of EFT	**Connected ?**	**Reasons**
Eddie Dean	Yes	Controls via position as Appointor
Susannah Dean (Eddie's wife)	No	Pattern of distribution test not satisfied in respect of EFT
Tower Property Trust (TPT)	No	Susannah holds 100% of units
Tower Equities Trust (TET)	Yes	Susannah appointor but Eddie also has control - pattern of distributions
Tower Investments Pty Limited	Yes	Shares owned 100% by EFT

Total NAV of EFT & its connected entities

Eddie Family Trust (EFT)	5,000,000
Eddie Dean	600,000
Tower Equities Trust (TET)	250,000
Tower Investments Pty Limited	50,000
	5,900,000

Conclusion: ***Satisfies NAV Test***

Applying the grouping rules

2. The following will be connected entities of EFT, for the reasons stated.

   - *Eddie Dean* – would be treated as controlling EFT because he is the appointor, and the trustee could reasonably be expected to act in accordance with his wishes. In any case, as Eddie has received a majority of the distributions from EFT in each of the last four years, he would also be treated as having control over EFT under the 40% pattern of distributions test.

   - *Tower Equities Trust (TET)* – Eddie would be treated as having control under the 40% pattern of distributions rule, as he received 70% of the distributions in 2007. This is despite the fact that Susannah also has control as she is the appointor, and received most of the distributions in every other year.

   - *Tower Investments Pty Limited* – EFT has control as it owns all of the shares.

3. The following would not be connected entities or affiliates of EFT for the reasons stated.

   - *Susannah Dean* – individuals cannot be connected entities of each other, although they can in certain circumstances be affiliates.

     Spouses are no longer automatically treated as affiliates, and neither Eddie nor Susannah carries on a business in their own right, so they would not meet the general test for affiliates where one individual acts in accordance with the wishes of, or in concert with, the other individual in relation to the affairs of the other individual's business (see section 328-130).

     The 2009 amendments, which could deem Susannah and Eddie to be affiliates, do not apply in this case as they require a passive asset (such as real property used to derive rent) to be used in another entity's business.

   - *Tower Property Trust (TPT)* – this trust is controlled by Susannah, not Eddie, and therefore EFT and TPT are not under common control.

4. We can see that, as EFT is so close to the $6m limit, if either Susannah or TPT were treated as affiliates or connected entities of EFT then the NAV test would be breached.

Applying the active asset test

5. *The 80% 'look-through' test* - under section 152-40(3), a share in a company can be an active asset as long as the total market value of the company's active assets represents at least 80% of the market value of all of the company's assets. As High Flyer has no assets other than the business goodwill, this requirement will be satisfied.

6. *CGT concession stakeholder requirement* – under section 152-10(2), as EFT is selling shares in High Flyer, CGT concession stakeholders of High Flyer must have together a 'small business participation percentage' in EFT of at least 90%, i.e.:

   - Firstly, a CGT concession stakeholder in a company is someone who satisfies the significant individual test, or the spouse of that person.

   - A significant individual of a company is someone who holds an interest (their 'small business participation percentage'), directly or indirectly, in the company of at least 20%.

   - For a company, the participation percentage is based on *the smaller of* the percentage of voting power, dividend rights and capital rights

   - For discretionary trusts, the participation percentage is measured based on *the smaller of* the percentage entitlements to any distributions of income and capital during the year in which the CGT event takes place.

   - Where a discretionary trust owns one-third of the shares in a company, therefore, in order to have a 20% indirect interest in the company an individual must receive at least 60% of any distributions of income, and at least 60% of any distributions of capital, by the trust in the year of sale (i.e. 33.33% x 60% = 20%).

   So what does all this mean for Eddie and Susannah?

   - As long as Eddie receives at least 60% of the distributions made by EFT in the 2010 year, he will be a significant individual of High Flyer.

   - This in turn means that both Eddie and Susannah (his spouse) will be CGT concession stakeholders of High Flyer at the time of the share sale.

   - As long as Eddie and Susannah receive between them at least 90% of EFT's 2010 distributions, the 90% requirement will be satisfied.

Using the active asset small business 50% reduction

7. As set out below for scenario 2, the tax implications for the individual beneficiaries of EFT are:

    - Apply the 50% CGT discount to the gross capital gain of $5m.
    - Apply the 50% active asset reduction to the discount capital gain of $2.5m.
    - If no other concessions were utilized, the taxable capital gain would be $1.25m, i.e. 25% of the gross capital gain.
    - Assuming the top marginal tax rate of 46.5%, the tax payable by individual beneficiaries would be $581,250, leaving net proceeds of $4,418,750.

High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 2
Active Asset Concession on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***
Capital proceeds on share sale	15,000,000	5,000,000
Cost base for shares	-	-
Gross capital gain on cancellation of shares		5,000,000
Less - 50% CGT discount		(2,500,000)
Net capital gain		2,500,000
Less - 50% active asset reduction		(1,250,000)
Taxable capital gain		**1,250,000**
Total taxable income		1,250,000
Tax payable (assumed marginal tax rate 46.5%)		581,250
Less - franking credit		-
Net tax payable on share sale		**581,250**

Net received after tax by individual shareholders		
Capital profit on sale of shares	15,000,000	5,000,000
Franked dividend received	-	-
Tax payable by individuals	(1,743,750)	(581,250)
Net proceeds received after tax	**13,256,250**	**4,418,750**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**-11.63%**	(1,743,750)
Net proceeds received after tax	**88.38%**	**13,256,250**

Using the 15 year exemption

8. As EFT has not held its shares in High Flyer for 15 years, and in fact the company has not been in existence for this long, the 15 year exemption will not be available for the share sale by EFT.

9. *Hypothetical* - suppose, instead, that the business was established in 1991, and the Roland Family Trust (RFT) has held its shares since this date. As Eddie and Jake had bought out Roland's original partners in 2001, they remain ineligible for the 15 year exemption.

   - RFT has owned the asset (its shares in High Flyer) for at least 15 years.

   - The records back to 1991 reveal that Roland has been a significant individual of High Flyer for the entire period, as he received at least 60% of distributions made by RFT each year, meaning that he held at all times an interest in High Flyer of at least 20%. It is not essential that the significant individual be the same each year, just that there was one.

   - In practice, proving that there has been a significant individual over a period of 15 years will not always be an easy task. Other factors that may prevent the shareholder from using the 15 year exemption include an inability to prove that HFC passed the 80% "look-through" test for the shares to be an active asset, or the existence of discretionary dividend shares that can prevent dividend rights from being traced through to individuals.

   - Roland is a connected entity of RFT, having control under the pattern of distributions test, so his assets will be included when applying the grouping rules. Ruby is not automatically treated as Roland's affiliate, so her assets are excluded.

   - As the NAV test is applied at the date of the share sale, some or all of Roland's cash deposits could be invested in Ruby's name before this time. If, for example, Roland's own cash deposits were reduced to $750,000, the total NAV for the group would be $5.75m. Part IVA should of course be considered when undertaking any pre-sale restructuring.

   - The other key requirement for the 15 year exemption is that a significant individual is aged 55 or over at the time of the CGT event, and it happens in connection with their retirement. At the time of the proposed sale, Roland is aged 54, and Ruby is aged 56.

   - It would therefore be advisable for RFT to give Ruby at least 60% of any income and capital distributions in the 2010 year, ensuring that she qualifies as a significant individual. As Ruby's spouse, Roland would be a 'CGT concession stakeholder', and it should then be possible for RFT to pay the entire capital gain on the sale of the High Flyer shares to Ruby and Roland in appropriate proportions without any tax implications for them.

Using the small business retirement exemption

10. As set out below for scenario 3, the tax payable may be further reduced to around 2% of the gain by using the retirement exemption.

    - As Eddie is a significant individual of High Flyer, and Susannah is his spouse, payments can be made for each of them under the retirement exemption.

    - The choice to apply the retirement exemption will be made at the time of lodging EFT's 2010 tax return and, as both Eddie and Susannah will be aged less than 55 at this time, section 152-325(7) requires that the relevant payments must be made to a complying superannuation fund.

    - As neither individual has previously used the retirement exemption, they each have the full amount of their lifetime limit of $500,000 available to them. EFT makes the choice in writing on 10 April 2011, and lodges its 2010 tax return the same day. EFT then has 7 days to pay $1m into the Tower Superannuation Fund, and makes the payment on 16 April 2011.

    - The net taxable capital gain would therefore be reduced by $1m to $250,000 and, assuming a tax rate of 46.5%, the individual beneficiaries would pay tax of $116,250 in total, leaving net proceeds of $4,883,750 (although of course only $3,883,750 will be available outside of the super fund).

    - This represents a tax saving of $465,000 by applying the retirement exemption (i.e. $1m x 46.5%). Of course the saving is reduced where lower marginal tax rates apply to the beneficiaries, but the saving is still significant, especially considering that under the current superannuation rules the $1m comes out of the super fund tax free when Eddie and Susannah retire after the age of 60.

High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 3
Active Asset & Retirement Concessions on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***
Capital proceeds on share sale	15,000,000	5,000,000
Cost base for shares	-	-
Gross capital gain on cancellation of shares		5,000,000
Less - 50% CGT discount		(2,500,000)
Net capital gain		2,500,000
Less - 50% active asset reduction		(1,250,000)
Taxable capital gain (before further concessions)		1,250,000
Less - retirement concession		(1,000,000)
(max $500k per individual, i.e. $1m per couple)		
Taxable capital gain		**250,000**
Total taxable income		250,000
Tax payable (assumed marginal tax rate 46.5%)		116,250
Less - franking credit		-
Net tax payable on share sale		**116,250**

Net received after tax by individual shareholders		
Capital profit on sale of shares	15,000,000	5,000,000
Franked dividend received	-	-
Tax payable by individuals	(348,750)	(116,250)
Net proceeds received after tax	**14,651,250**	**4,883,750**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**-2.33%**	(348,750)
Net proceeds received after tax	**97.68%**	**14,651,250**

Using the small business replacement asset roll-over

11. This concession is often used as an alternative to the retirement exemption, to avoid the need to lock funds away in a super fund, but it can also be used in addition to the retirement exemption, where the remaining taxable capital gain exceeds the lifetime limit of the relevant individuals.

12. As set out on the attached schedule for scenario 4, EFT could use the roll-over to reduce the tax payable on the share sale to nil. This would require EFT to invest the amount of $250,000 in a replacement active asset, or improvements to an existing active asset, within a period starting one year before the CGT event, and ending two years after the CGT event. This can include trading stock and depreciating assets.

    If EFT wishes to invest in a company or unit trust carrying on a business this can qualify as a replacement asset, but as discussed below care should be taken.

High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 4
Active Asset, Retirement & Rollover Concessions on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***
Capital proceeds on share sale	15,000,000	5,000,000
Cost base for shares	-	-
Gross capital gain on cancellation of shares		5,000,000
Less - 50% CGT discount		(2,500,000)
Net capital gain		2,500,000
Less - 50% active asset reduction		(1,250,000)
Taxable capital gain (before further concessions)		1,250,000
Less - retirement concession		(1,000,000)
(max $500k per individual, i.e. $1m per couple)		
		250,000
Less - replacement asset rollover		(250,000)
Taxable capital gain		**-**
Net tax payable on share sale		**-**

Net received after tax by individual shareholders		
Capital profit on sale of shares	15,000,000	5,000,000
Franked dividend received	-	-
Tax payable by individuals	-	-
Net proceeds received after tax	**15,000,000**	**5,000,000**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**0.00%**	-
Net proceeds received after tax	**100.00%**	**15,000,000**

Analysis – issues for EFT to consider when using the small business roll-over

1. If EFT chooses to apply small business roll-over relief, Eddie will need to ensure that at the end of the two year replacement asset period (i.e. on 23 December 2011) it either holds new replacement assets that qualify as active assets, or has incurred expenditure to improve existing active assets that it still hold at that time.

2. A key point to remember is that the same entity that sold the asset must be the one that acquires the replacement asset, i.e. it is not sufficient that Eddie uses some of the proceeds received from the share sale by EFT to invest in his own name.

3. While a share in a company or interest in a trust can qualify as a replacement asset, it is important to ensure that certain additional requirements are satisfied, being:

    - The company or trust is an Australian resident;

    - The total market value of the entity's active assets, financial instruments inherently connected with the business, and cash inherently connected with the business, is at least equal to 80% of the market value of all its assets; and

    - For widely held companies, the shares are held by a CGT concession stakeholder (i.e. a significant individual or their spouse).

4. Suppose that, under the sale agreement, Eddie stays on as a director working in the High Flyer business, and is offered the opportunity to acquire 25,000 ordinary shares in Gilead Holdings Pty Limited at their current market value of $10 per share, giving EFT a stake of 2%.

5. Eddie establishes a new unit trust the Tet Holding Trust (THT), and EFT pays $250,000 to subscribe for 100% of the units in THT. The purpose of THT is to take up the shares in Gilead Holdings, and it uses the $250,000 to do this. EFT then seeks to treat the units in THT as replacement assets for the small business roll-over.

6. As THT's only asset is the shares in Gilead Holdings, it is reasonable to expect that both THT and Gilead Holdings satisfy the 80% 'look through rule', i.e. Gilead's assets are virtually all business-related and, because it is an Australian resident and is not a widely held company, the units in THT that EFT has acquired will therefore satisfy the requirements to be treated as replacement assets.

7. It is necessary for Eddie to use the new trust rather than having EFT acquire the shares in Gilead Holdings directly, to avoid triggering CGT event J5 at the end of the 2 year replacement asset period. Under Section 104-197(2), a capital gain would be triggered at this time unless the holder is a CGT concession stakeholder in the relevant entity, or satisfies the 90% test for interposed entities.

8. Rollover would not be available for a direct acquisition of Gilead Holdings shares as EFT would hold only 2%, but the small business rollover can apply for an acquisition of units in THT, because EFT owns 100% of the units and steps can be taken to ensure that Eddie and Susannah have between them 'participation percentages' in EFT of at least 90%. The point is that the replacement asset is the parcel of units in THT, not the shares in Gilead Holdings.

9. It is important to note that this approach would not work if Gilead Holdings had been a widely held company, because its shares could not have qualified as active assets. THT being a trust can never satisfy the requirement to be a CGT concession stakeholder of Gilead Holdings, i.e. the shares would need to be held by Eddie or Susannah personally, not by a related entity, and one of them would need to hold a stake in Gilead Holdings of at least 20%. This means it will be difficult for shares in widely held companies to be treated as active assets, even using interposed entities.

10. By adopting the structure proposed above, the units in THT will qualify as active assets and, assuming EFT holds the units beyond the two year replacement asset period, the $250,000 rolled over capital gain will continue to be carried forward until such time as the units themselves are sold, or THT sells its shares in Gilead Holdings so that THT no longer holds any active assets. In either case, the sale would trigger CGT event J2.

11. CGT would generally apply to the rolled over capital gain of $250,000, noting that the 50% CGT discount and the 50% active asset reduction cannot apply as they were already applied on the original share sale, nor can the 15-year exemption be used. It is possible, however, to utilise either a further small business roll-over or the retirement exemption (subject to the $500,000 lifetime limit).

Conclusion

As illustrated in the High Flyer Case Study, there are tremendous opportunities to be found in the small business CGT concessions when selling a business. Its also worth bearing in mind that, even if your client is not ready to sell, the concessions can allow important restructuring to take place in a tax effective way, so that tax doesn't become an impediment to the growth of the business.

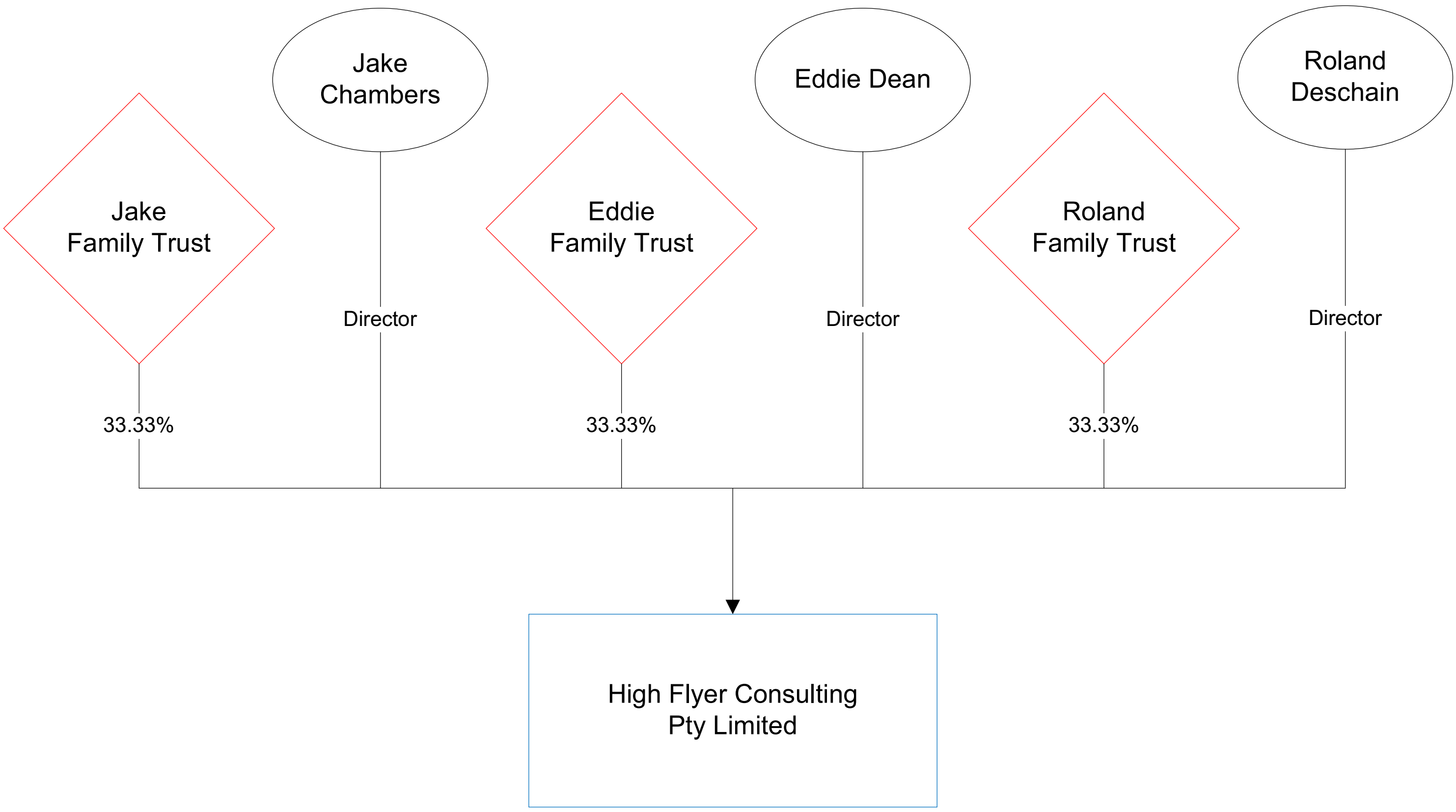
The concessions have become a lot more favourable over the last few years, with several major batches of legislative changes, and with the added benefits has come added complexity. The case study shows how the way the transaction is structured, the way the client's entities are structured, and the history of their structure, can all have a bearing on the ability to use the CGT concessions.

There are plenty of traps of which business owners need to be aware, and in this area as much as any other it is essential to plan as early as possible. By the time the business owner has an offer on the table, it may be too late to correct any problems that may restrict their ability to make maximum use of the small business CGT concessions. Now is the time to start planning for a possible sale.

Small Business CGT Concessions

Case Study

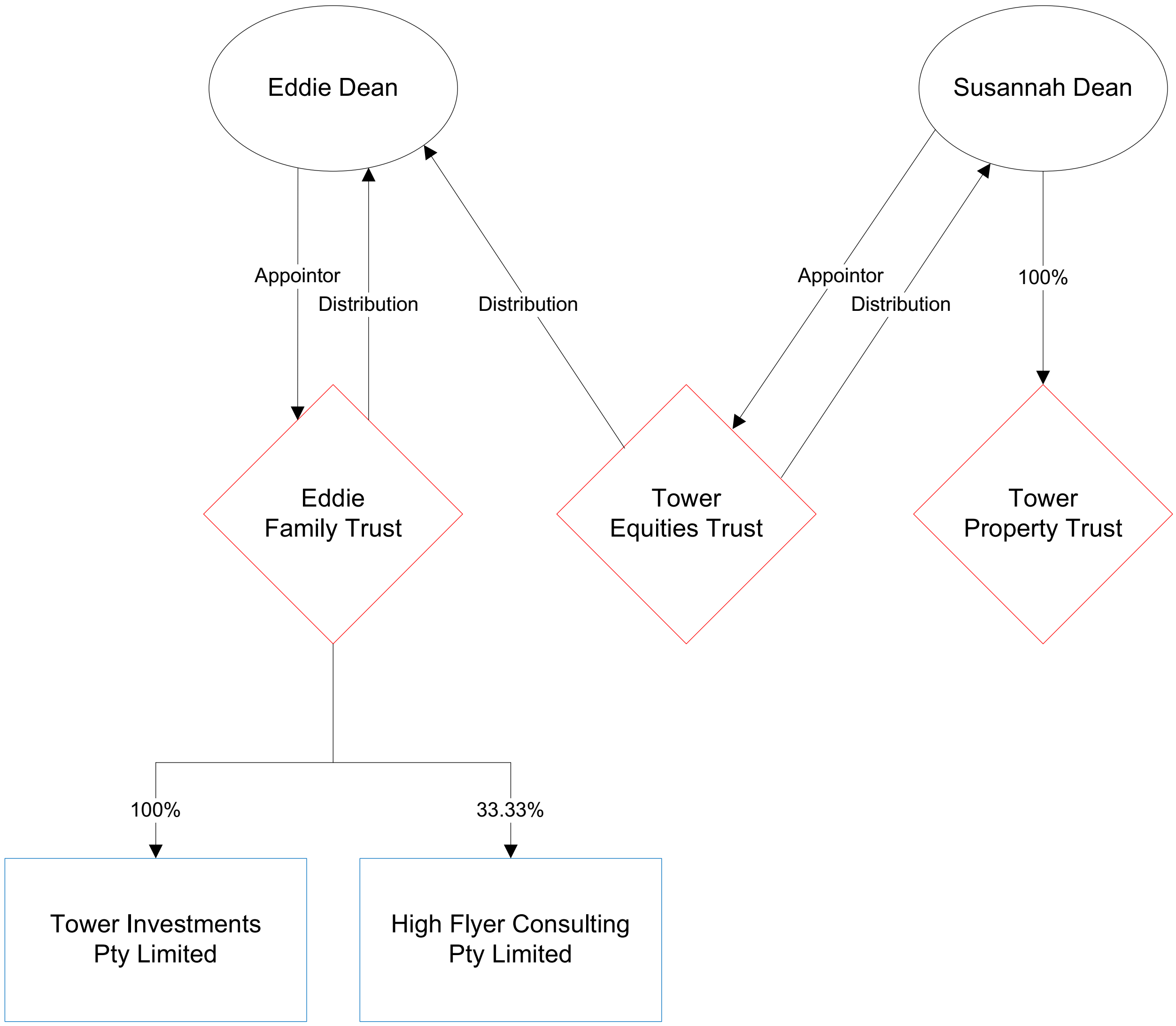
High Flyer Consulting Pty Limited Shareholders



Small Business CGT Concessions

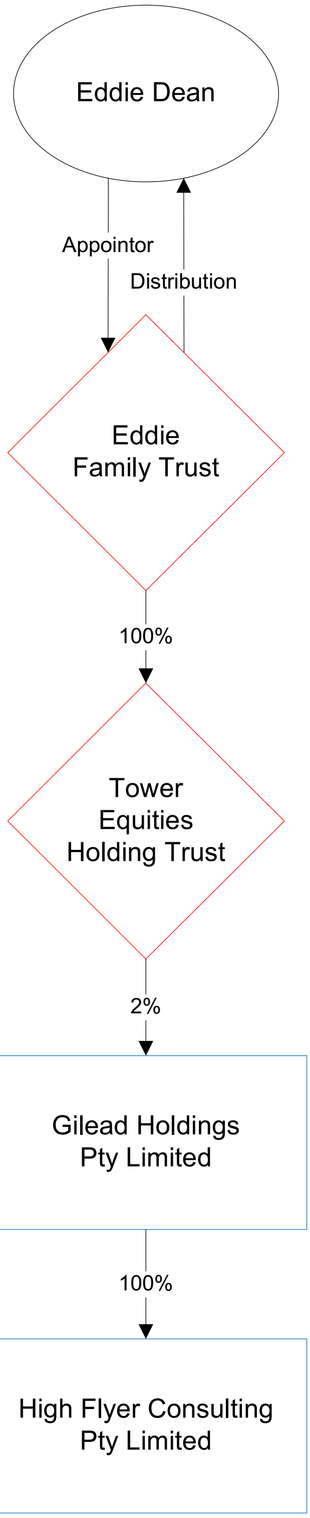
Case Study

Eddie Dean's Group Structure



Small Business CGT Concessions

Case Study
Eddie Dean's Group Structure
After Sale



High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Summary of Different Scenarios

Scenario	Description	Gross Proceeds	Total Tax Payable	Net Proceeds	Tax Payable per family	Net Proceeds per family
1	No concessions (asset sale - worst case)	15,000,000	(6,975,000)	8,025,000	(2,325,000)	2,675,000
2	Active asset concession (share sale)	15,000,000	(1,743,750)	13,256,250	(581,250)	4,418,750
3	Retirement concession (share sale)	15,000,000	(348,750)	14,651,250	(116,250)	4,883,750
4	Retirement & rollover concessions (share sale)	15,000,000	-	15,000,000	-	5,000,000

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High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 1
No concessions available

Sell business assets

Tax payable by companies on sale of assets

Sale proceeds	15,000,000
Less - CGT cost base (assumed nil)	-
Gross capital gain	15,000,000
Less - 50% active asset reduction	
Taxable capital gain	**15,000,000**
Tax payable at 30%	**4,500,000**

Retained profits in company

Capital profit on sale of business	15,000,000
Tax payable	(4,500,000)
Accounting profit after tax	**10,500,000**
Retained profits arising from sale	**10,500,000**
CGT Exempt Component (distribute as capital on liquidation)	**-**
	10,500,000

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***	***Jake F/T***	***Roland F/T***
Franked dividend paid				
Franked dividend payable (on liquidation or otherwise)	10,500,000	3,500,000	3,500,000	3,500,000
Gross up for franking credit	4,500,000	1,500,000	1,500,000	1,500,000
Taxable dividend	**15,000,000**	**5,000,000**	**5,000,000**	**5,000,000**
Distribution on Liquidation (if applicable)				
Capital distribution on liquidation (ignoring paid up capital)		-	-	-
Cost base for shares		-	-	-
Gross capital gain on cancellation of shares		-	-	-
Less - 50% CGT discount		-	-	-
Net capital gain		-	-	-
Less - 50% active asset reduction		-	-	-
Taxable capital gain		**-**	**-**	**-**
Total taxable income		5,000,000	5,000,000	5,000,000
Tax payable (assumed marginal tax rate 46.5%)		2,325,000	2,325,000	2,325,000
Less - franking credit		(1,500,000)	(1,500,000)	(1,500,000)
Net tax payable on total distributions made		**825,000**	**825,000**	**825,000**

Net received after tax by individual shareholders

Capital profit on cancellation of shares	-	-	-	-
Franked dividend paid	10,500,000	3,500,000	3,500,000	3,500,000
Tax payable by individuals	(2,475,000)	(825,000)	(825,000)	(825,000)
Net proceeds received after tax	**8,025,000**	**2,675,000**	**2,675,000**	**2,675,000**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**-30.00%**	(4,500,000)
Tax payable by individual beneficiaries	**-16.50%**	(2,475,000)
Net proceeds received after tax	**53.50%**	**8,025,000**

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High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 2
Active Asset Concession on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***	***Jake F/T***	***Roland F/T***
Capital proceeds on share sale	15,000,000	5,000,000	5,000,000	5,000,000
Cost base for shares	-	-	-	-
Gross capital gain on cancellation of shares		5,000,000	5,000,000	5,000,000
Less - 50% CGT discount		(2,500,000)	(2,500,000)	(2,500,000)
Net capital gain		2,500,000	2,500,000	2,500,000
Less - 50% active asset reduction		(1,250,000)	(1,250,000)	(1,250,000)
Taxable capital gain		**1,250,000**	**1,250,000**	**1,250,000**
Total taxable income		1,250,000	1,250,000	1,250,000
Tax payable (assumed marginal tax rate 46.5%)		581,250	581,250	581,250
Less - franking credit		-	-	-
Net tax payable on share sale		**581,250**	**581,250**	**581,250**

Net received after tax by individual shareholders				
Capital profit on sale of shares	15,000,000	5,000,000	5,000,000	5,000,000
Franked dividend received	-	-	-	-
Tax payable by individuals	(1,743,750)	(581,250)	(581,250)	(581,250)
Net proceeds received after tax	**13,256,250**	**4,418,750**	**4,418,750**	**4,418,750**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**-11.63%**	(1,743,750)
Net proceeds received after tax	**88.38%**	**13,256,250**

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High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 3
Active Asset & Retirement Concessions on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***	***Jake F/T***	***Roland F/T***
Capital proceeds on share sale	15,000,000	5,000,000	5,000,000	5,000,000
Cost base for shares	-	-	-	-
Gross capital gain on cancellation of shares		5,000,000	5,000,000	5,000,000
Less - 50% CGT discount		(2,500,000)	(2,500,000)	(2,500,000)
Net capital gain		2,500,000	2,500,000	2,500,000
Less - 50% active asset reduction		(1,250,000)	(1,250,000)	(1,250,000)
Taxable capital gain (before further concessions)		1,250,000	1,250,000	1,250,000
Less - retirement concession		(1,000,000)	(1,000,000)	(1,000,000)
(max $500k per individual, i.e. $1m per couple)				
Taxable capital gain		**250,000**	**250,000**	**250,000**
Total taxable income		250,000	250,000	250,000
Tax payable (assumed marginal tax rate 46.5%)		116,250	116,250	116,250
Less - franking credit		-	-	-
Net tax payable on share sale		**116,250**	**116,250**	**116,250**

Net received after tax by individual shareholders				
Capital profit on sale of shares	15,000,000	5,000,000	5,000,000	5,000,000
Franked dividend received	-	-	-	-
Tax payable by individuals	(348,750)	(116,250)	(116,250)	(116,250)
Net proceeds received after tax	**14,651,250**	**4,883,750**	**4,883,750**	**4,883,750**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**-2.33%**	(348,750)
Net proceeds received after tax	**97.68%**	**14,651,250**

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High Flyer Consulting Pty Limited
Tax Calculations on Sale of Business
Scenario 4
Active Asset, Retirement & Rollover Concessions on Share Sale

Tax payable by individual beneficiaries of family trusts	***Total***	***Eddie F/T***	***Jake F/T***	***Roland F/T***
Capital proceeds on share sale	15,000,000	5,000,000	5,000,000	5,000,000
Cost base for shares	-	-	-	-
Gross capital gain on cancellation of shares		5,000,000	5,000,000	5,000,000
Less - 50% CGT discount		(2,500,000)	(2,500,000)	(2,500,000)
Net capital gain		2,500,000	2,500,000	2,500,000
Less - 50% active asset reduction		(1,250,000)	(1,250,000)	(1,250,000)
Taxable capital gain (before further concessions)		1,250,000	1,250,000	1,250,000
Less - retirement concession		(1,000,000)	(1,000,000)	(1,000,000)
(max $500k per individual, i.e. $1m per couple)				
		250,000	250,000	250,000
Less - replacement asset rollover		(250,000)	(250,000)	(250,000)
Taxable capital gain		**-**	**-**	**-**
Total taxable income		**-**	**-**	**-**
Tax payable (assumed marginal tax rate 46.5%)		-	-	-
Less - franking credit		-	-	-
Net tax payable on share sale		**-**	**-**	**-**

Net received after tax by individual shareholders	Total	Eddie F/T	Jake F/T	Roland F/T
Capital profit on sale of shares	15,000,000	5,000,000	5,000,000	5,000,000
Franked dividend received	-	-	-	-
Tax payable by individuals	-	-	-	-
Net proceeds received after tax	**15,000,000**	**5,000,000**	**5,000,000**	**5,000,000**

Gross capital proceeds received	**100.00%**	15,000,000
Tax payable by company	**0.00%**	-
Tax payable by individual beneficiaries	**0.00%**	-
Net proceeds received after tax	**100.00%**	**15,000,000**

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Eddie Family Trust (EFT)
Application of Net Asset Value (NAV) Test
Sale of Shares in High Flyer Consulting Pty Limited

Potential Connected Entities of EFT	Connected ?	Reasons
Eddie Dean	Yes	Controls via position as Appointor
Susannah Dean (Eddie's wife)	No	Pattern of distribution test not satisfied in respect of EFT
Tower Property Trust (TPT)	No	Susannah holds 100% of units
Tower Equities Trust (TET)	Yes	Susannah appointor but Eddie also has control - pattern of distributions
Tower Investments Pty Limited	Yes	Shares owned 100% by EFT

Net assets of various individuals and entities

Eddie Dean		
Investment property (50% share)	500,000	Valued at $1m, jointly held with Susannah
Listed equities	250,000	
Investment loan for shares	(150,000)	
	600,000	
Susannah Dean		
Investment property (50% share)	500,000	Valued at $1m, jointly held with Eddie
Managed funds	1,000,000	
Loan owing by her sister Odetta	100,000	
	1,600,000	
Tower Property Trust (TPT)		
Investment properties	3,000,000	
Investment loans for properties	(2,500,000)	
	500,000	
Tower Equities Trust (TET)		
Listed equities	1,500,000	
Unlisted equities	750,000	
Investment loan for equities	(2,000,000)	
	250,000	
Tower Investments Pty Limited		
Cash on deposit	50,000	
	50,000	
Eddie Family Trust (EFT)		
Shares in High Flyer Consulting	5,000,000	
Shares in Tower Investments	50,000	
Less - shares in connected entity	(50,000)	
	5,000,000	

Total NAV of EFT & its connected entities

Eddie Family Trust (EFT)	5,000,000
Eddie Dean	600,000
Tower Equities Trust (TET)	250,000
Tower Investments Pty Limited	50,000
	5,900,000

Conclusion: ***Satisfies NAV Test***