Advanced guide to capital gains tax concessions for small business 2005-06

This guide explains the CGT concessions available to small business and the conditions that must be met to apply.

Last updated 10 September 2007

A number of legislative changes have been made to the concessions outlined in this guide. These changes apply to CGT events that happen in the 2006-07 and later income years. This guide remains correct for the 2005-06 income year.

Introduction

This guide explains the capital gains tax (CGT) concessions available for small business that are contained in **Division 152 of the Income Tax Assessment Act 1997** (ITAA 1997). These concessions apply to CGT events happening after 11.45am, by legal time in the Australian Capital Territory, on 21 September 1999.

This guide does not explain how the concessions apply to a consolidated group of entities.

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Small business 15-year exemption

Small business 50% active asset reduction

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Overview

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CGT discount may be available to some entities

Where we refer to 'after 11.45am on 21 September 1999' we are referring to after 11.45am, by legal time in the Australian Capital Territory, on 21 September 1999.

Some entities (including individuals) that make a capital gain after 11.45am on 21 September 1999 from a capital gains tax (CGT) asset acquired before that time and owned for at least 12 months may choose to index the cost base (frozen as at 30 September 1999) or apply the CGT discount if certain conditions are satisfied.

Indexation is not available for assets acquired after 11.45am on 21 September 1999 but the CGT discount may apply if the relevant conditions are met.

The discount reduces a capital gain made by individuals (including partners in partnerships) and trusts by 50%. There are further rules for beneficiaries of trusts who are entitled to a share of a trust capital gain. Companies are ineligible for the CGT discount.

You offset capital losses against capital gains before applying the CGT discount. The CGT discount is applied before the small business CGT concessions (apart from the small business 15-year exemption).

When we use the terms 'you' and 'your' in this guide, we are referring to any individual (such as a sole trader), partner of a partnership, company or trust that conducts a small business.

The main condition for the CGT discount is that you must have acquired the CGT asset at least 12 months before the CGT event giving rise to the capital gain. There are rules to prevent circumvention of the 12-month requirement. Certain CGT events, such as where new assets are created, do not qualify for the CGT discount because the 12-month rule would not be satisfied.

The CGT discount can apply to capital gains made on non-business assets as well as business assets.

More information:

- Guide to capital gains tax 2005–06 (NAT 4151)
- Division 115 of the Income Tax Assessment Act 1997

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Small business concessions

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There are four small business CGT concessions available, namely:

- the small business 15-year exemption
- the small business 50% active asset reduction
- the small business retirement exemption, and
- the small business rollover.

These concessions may apply to CGT events (for example, the disposal of a CGT asset) that happen after 11.45am on 21 September 1999. Any capital gain that results from a CGT event may be reduced or disregarded under the small business concessions if you satisfy certain conditions.

The small business 15-year exemption provides a total exemption of a capital gain if you have continuously owned the CGT asset for at least 15 years and the relevant individual is aged 55 or over and retiring, or is permanently incapacitated.

The small business 50% active asset reduction provides a 50% reduction of a capital gain.

The small business retirement exemption provides an exemption of capital gains up to a lifetime limit of $500,000. If the recipient is under 55 years of age, the amount must be paid into a superannuation (or similar) fund.

The small business rollover provides a deferral of a capital gain if a replacement asset is acquired. The deferred capital gain may later crystallise if the replacement asset is disposed of or its use changes in particular ways. This means you would make a capital gain equal to the deferred gain (in addition to any capital gain made on the disposal of the replacement asset - see the example).

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Applying capital losses

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If the small business 15-year exemption applies, you do not reduce the capital gain by any capital losses before applying that concession.

In all other cases, you apply the CGT discount and the small business concessions to the capital gain after it has been reduced by any current and prior year capital losses.

If you have more than one capital gain, you can choose the order in which your capital gains are reduced by your capital losses.

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Applying the discount and concessions

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The small business 15-year exemption takes priority over the other small business concessions and the CGT discount. If the small business 15-year exemption applies, you entirely disregard the capital gain so there is no need to apply any further concessions.

If the 15-year exemption doesn't apply, you apply the CGT discount (if applicable) to the capital gain before applying the remaining small business concessions.

If you satisfy the conditions for more than one of the remaining small business concessions, you may apply each of those concessions to different parts of the capital gain.

After applying any capital losses, individuals and trusts eligible for both the CGT discount and the small business 50% active asset reduction can reduce a capital gain by 75% (that is, by 50% then 50% of the remainder).

The order in which you apply capital losses and the CGT concessions to capital gains is shown in the flowchart on the next page.

Example

Ken is a small business operator who sells an active asset that he has owned for more than 12 months. He makes a capital gain of $20,000. Ken also has a separate capital loss of $4,000. Assuming he satisfies all the conditions for the CGT discount and the small business 50% active asset reduction, Ken calculates his net capital gain as follows:

Capital gain	$20,000
Deduct capital loss	$4,000
Subtotal	**$16,000**
Apply 50% CGT discount	$8,000
Subtotal	**$8,000**
Apply 50% small business active asset reduction	$4,000
Reduced capital gain	**$4,000**

Ken may be able to further reduce his $4,000 (reduced) capital gain using the small business retirement exemption and/or small business rollover if he satisfies the conditions for those concessions.

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Order in which to apply the discount and concessions

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Note that you make a capital gain from a depreciating asset only to the extent that you have used the depreciating asset for a non-taxable purpose. Step 1: Determine whether you satisfy the basic conditions for the small business CGT concessions. If so, go to step 2. If not, go to step 3. Step 2: Determine whether you qualify for the small business 15-year exemption (not relevant to capital gains from depreciating assets). If yes, disregard the entire capital gain. You don't need to apply any of the other CGT concessions. Step 3: Offset any capital losses against the capital gain. Step 4: Determine whether you are eligible for the CGT discount. For recent changes go to CGT discount. If so, reduce the remaining capital gain. Go to step 5. Step 5: Determine whether the capital gain is from a depreciating asset and used at least partly for a non-taxable purpose. If so, you are not eligible for any other concessions and can't reduce your capital gain any further. If not, go to step 6. Step 6: Determine whether you qualify for the small business 50% active asset reduction (if you answered yes at step 1 you will qualify). If so, reduce the remaining capital gain. You can choose not to apply the 50% active asset reduction and go straight to the small business retirement exemption or rollover in step 7. Step 7: Determine whether you qualify for the small business retirement exemption or rollover. If so, reduce the remaining capital gain. Amount remaining equals the net capital gain to be included in your assessable income for the year. Keep the necessary CGT records.

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Depreciating assets

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Special rules apply to depreciating assets. A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Plant and equipment used in your business are examples of depreciating assets.

Under the uniform capital allowances system that applies from 1 July 2001, any gain or loss from a depreciating asset is included in your assessable income, or deductible as a balancing adjustment, to the extent the asset was used for a taxable purpose (for example, to produce assessable income). The small business CGT concessions do not apply to gains you make on depreciating assets that are included in your income under the uniform capital allowances system.

You make a capital gain or capital loss from a depreciating asset to the extent you have used the depreciating asset for a non-taxable purpose (for example, for private purposes - CGT event K7). Any capital gain you make in this way does not qualify for the small business concessions because it reflects the non-business use of the asset.

However, as depreciating assets are still CGT assets, they must be included in the maximum net asset value test. A depreciating asset may also be an active asset and may be chosen as a replacement asset under the small business rollover.

More information:

- Guide to depreciating assets 2005–06 (NAT 1996)

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Choosing the small business concessions

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You must choose the 15-year exemption, the retirement exemption and the rollover for those concessions to apply. However, the 50% active asset reduction applies automatically if the basic conditions are satisfied and you have not specifically chosen that it not apply.

Generally, a choice available under the CGT law must be made by the day you lodge your income tax return for the income year in which the relevant CGT event happened, or within such further time as the Commissioner allows.

The way you prepare your income tax return is generally sufficient evidence of the choice you have made. However, the retirement exemption requires you to keep a written record of the amount you choose to disregard.

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Basic conditions for the small business CGT concessions

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The basic conditions are contained in Subdivision 152-A of the Income Tax Assessment Act 1997).

Basic conditions

Maximum net asset value test

Active asset test

Controlling individual test

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Basic conditions

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To qualify for the small business CGT concessions, you must satisfy several conditions that are common to all the concessions. These are called the 'basic conditions'.

Each concession also has further requirements that you must satisfy for the concession to apply (except for the small business 50% active asset reduction which applies if the basic conditions are satisfied).

The major basic conditions are in the form of three tests that must be satisfied:

- the maximum net asset value test which sets a $5 million limit on the net value of assets that you and certain related entities can own
- the active asset test, and
- if the CGT asset is a share in a company or interest in a trust
  - the controlling individual test, and
  - the individual claiming the concession must be a CGT concession stakeholder in the company or trust.

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Maximum net asset value test

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There is a limit of $5 million on the net value of the CGT assets that you and certain related entities can own and still qualify for the small business CGT concessions. This $5 million limit is called the **maximum net asset value test**. The $5 million limit is not indexed for inflation.

You satisfy the maximum net asset value test if the total **net value of CGT assets** owned by:

- you
- any entities connected with you, and
- any of your small business CGT affiliates or entities connected with your small business CGT affiliates (subject to the note below)

does not exceed $5 million just before the CGT event that results in the capital gain for which the concessions are sought.

The assets of your small business CGT affiliates, or entities connected with your small business CGT affiliates, are included in the maximum net asset value test only if those assets are used, or held ready for use, in a business carried on by you or by an entity connected with you (but not an entity connected with you only because of your small business CGT affiliate).

Example

Colin operates a newsagency business as a sole trader. His wife Sally carries on her own florist business, which is unrelated to the newsagency business. Sally owns the land and building from which the newsagency is conducted and leases it to Colin. Sally is Colin's small business CGT affiliate.

In determining whether he satisfies the maximum net asset value test, Colin includes the market value of the land and building owned by Sally (because it is used in his newsagency business) but does not include Sally's other assets used in her florist business (because they are not used in the newsagency business).

Additional test for partnerships

If you are a partner in a partnership and the CGT event happens in relation to a CGT asset of the partnership (for example, a partnership asset is disposed of), the net value of the CGT assets of the partnership also must not exceed $5 million.

This additional test does not apply if a partner in a partnership disposes of an interest in a partnership asset (and the other partners retain their interest in the partnership asset). This is because a partner's interest in a partnership asset is a CGT asset of the partner and not of the partnership.

Meaning of net value of CGT assets

The **net value of the CGT assets** of an entity is:

> Sum of the market values of those assets
>
> **less**
>
> any liabilities of the entity that are related to those assets

Assets to be included in determining the net value of CGT assets are not restricted to business assets and include all CGT assets of the entity, unless the assets are specifically excluded (as noted below).

Although gains from depreciating assets may be treated as income rather than capital gains, depreciating assets are still CGT assets and are therefore included when calculating the net asset value.

Assets excluded from the net value of CGT assets

Some interests in connected entities

To avoid double counting when calculating the net value of your CGT assets, you disregard any shares, units or other interests (apart from debt) that you hold in an entity connected with you or your small business CGT affiliate. This is because the net value of the CGT assets of the connected entity is already included in the test.

Assets solely for personal use, superannuation assets

If you are an individual, also disregard the following assets when working out the net value of your CGT assets:

- assets being used solely for your personal use and enjoyment, or that of your small business CGT affiliate
- rights to amounts payable out of a superannuation fund or an approved deposit fund
- rights to an asset of a superannuation fund or an approved deposit fund, and
- insurance policies on the life of an individual.

Individual's own home if incidental income-producing use

If an individual's own home is not used solely for personal use and enjoyment only because of some incidental income-producing use, the home is also excluded from the maximum net asset value test.

However, if the individual had incurred interest on a loan taken out to purchase the home and would have been able to be deduct at least some of that interest from their assessable income, the total market value of their home is included in the maximum net asset value test, even if it is predominantly used for private purposes.

The individual would be entitled to deduct part of the interest on money they borrowed to buy the home if:

- part of the home is set aside exclusively as a place of business and is clearly identifiable as such, and
- that part of the home is not readily adaptable for private use, for example, a doctor's surgery located within a doctor's home.

This is a hypothetical interest deductibility test. If the individual did not actually incur any interest, the test looks at whether they would have been entitled to a deduction if they had taken out a loan to purchase their home.

Example

John is a sole trader. The market value of his CGT assets is as follows:

Business premises	$500,000
Business goodwill	$200,000
Trading stock	$100,000
Plant	$50,000
Boat (used solely for personal use)	$50,000
Residence (used solely for personal use)	$300,000

There is a mortgage on the business premises of $400,000. John also borrowed $20,000 to buy the boat.

John does not include the market value of his residence and boat, or the liability relating to the boat, when calculating the net value of his CGT assets. The net value of John's CGT assets is therefore $850,000 − $400,000 = $450,000.

If John used his residence partially for income-producing purposes such that he would have been entitled to a deduction for interest if he had borrowed money to acquire the residence, he would include the market value of the residence in the net value of his CGT assets. For example, if he had a $100,000 mortgage on the residence, the net value of John's CGT assets would be $1,150,000 − $500,000 = $650,000.

Who is a small business CGT affiliate?

Your spouse, or child under 18 years, is a **small business CGT affiliate** of yours.

A person is also your small business CGT affiliate if they act, or could reasonably be expected to act:

- in accordance with your directions or wishes, or
- in concert with you.

However, if you are a partner in a partnership, another partner is not your small business CGT affiliate only because that partner acts, or could reasonably be expected to act, in concert with you in relation to the affairs of the partnership.

When is an entity connected with you?

An entity is **connected with** another entity if:

- either entity controls the other entity, or
- both entities are controlled by the same third entity.

Connected with - control of a partnership, company or trust (except a discretionary trust)

An entity controls another entity if it, its small business CGT affiliates, or all of them together:

- beneficially own/s or has/have the right to acquire beneficial ownership of, interests in the other entity that give the right to receive at least 40% (the control percentage) of any distribution of income or capital by the other entity, or
- if the other entity is a company, beneficially own/s, or has/have the right to acquire beneficial ownership of, shares in the company that give at least 40% of the voting power in the company.

Example

Olivia and Jill conduct a professional practice in partnership. As they each have a 50% interest in the partnership they each control the partnership. The partnership is therefore connected with each partner, and Olivia and Jill are each connected with the partnership.

Example

Yusef is a sole trader. He also owns shares in a company that carry 50% of the voting power in the company. The net value of his CGT assets (apart from the shares in the company) is $3 million. In determining whether he satisfies the maximum net asset value test, Yusef must take into account the net value of his CGT assets ($3 million) and the net value of the company's CGT assets because the company is connected with him. He does not include the market value of his shares in the company in the net value of his CGT assets because this amount is already reflected in the net value of the company's CGT assets.

Control where interest is at least 40% but less than 50%

If an entity's control percentage in another entity is at least 40% but less than 50%, the Commissioner may determine that the first entity does not control the other entity if he is satisfied that a third entity (not including any small business CGT affiliates of the first entity) controls the other entity.

For an entity to be controlled by a third entity, the third entity must also have a control percentage of at least 40% in the entity. That is, it must control the entity in the way described above. In working out the third entity's control percentage, the interests of any small business CGT affiliates of the third entity are taken into account.

In other words, for the Commissioner to be able to determine that an entity does not control another entity, there must be a third entity that has a control percentage (including the interests of any small business CGT affiliates) of at least 40% in the other entity.

Example

X Co conducts a business and has 10 shareholders. Y Co owns 45% of the shares in X Co. The other shareholders each own between 2% and 20% of the shares in X Co. The shareholder holding 20% of the shares runs the company. All the shares have equal voting and distribution rights and none of the shareholders is a small business CGT affiliate of another shareholder.

In this case, the next largest shareholder in X Co after Y Co owns 20%. As there is no third entity with a control percentage of at least 40%, the Commissioner cannot determine that Y Co does not control X Co.

If there was a third entity with a control percentage of at least 40% (that is, there were two shareholders with a control percentage of at least 40%) it would be necessary to consider additional factors to determine if the third entity controls it. Such additional factors could include who is responsible for the day-to-day and strategic running of the company.

Example

Lachlan owns 45% of the shares in a private company. He plays no part in the day-to-day or strategic running of the business. Daniel owns the other 55% of the shares in the company. All shares carry the same voting rights and Daniel runs the company. Even though Lachlan owns 45% of the shares in the company, he would not be taken to control the company because the Commissioner would be satisfied that the company is controlled by Daniel.

Alternatively, it is possible that both of the entities with a control percentage of at least 40% may control the company if such responsibilities are shared.

Connected with - control of a discretionary trust

Proposed changes to the control test for discretionary trusts have now become law. They were previously announced by the government in Assistant Treasurer Media Release CO97/03 on 16 October 2003 and were introduced into Parliament in Tax Laws Amendment (2004

Measures No. 1) Bill 2004 on 19 February 2004. The new rules are set out below.

Subject to certain transitional rules, the changes apply to CGT events happening after 11.45 am, by legal time in the Australian Capital Territory, on 21 September 1999.

Control by trustee

An entity may control a discretionary trust if the entity, its small business CGT affiliates, or all of them together:

- is/are the trustee of the discretionary trust (other than the public trustee of a state or territory), or
- has/have the power to determine how the trustee makes distributions of income or capital to the beneficiaries of the trust.

However, this will be the case only if certain beneficiaries are not taken to control the trust.

If a beneficiary of a discretionary trust controls the trust and the beneficiary is not a small business CGT affiliate of the trustee, or of a person who has the power to determine how the trustee makes distributions, then the trustee or that other person will not also be taken to control the discretionary trust.

Control by beneficiary

The level of actual distributions made by a discretionary trust is used to determine who controls the trust. Subject to certain transitional arrangements, a beneficiary is taken to control a discretionary trust only if, for any of the four income years before the year for which relief is sought for a CGT event:

- the trustee paid to, or applied for the benefit of, the beneficiary and/or their small business CGT affiliates (for example, their spouse or child under the age of 18) any of the income or capital of the trust, and
- the amounts paid or applied were at least 40% (the control percentage) of the total amount of income or capital paid or applied for that income year (subject to the Commissioner's discretion where the control percentage is between 40% and 50%).

Exempt entities and deductible gift recipients are not treated as controlling a discretionary trust regardless of the percentage of distributions made to them.

To determine if a particular beneficiary controls a trust, amounts paid to or applied for the benefit of any of the beneficiary's small business CGT affiliates are also included when determining whether the beneficiary reaches the 40% threshold.

Distributions of income and capital made to the same beneficiary are considered separately (that is, not added together) to determine if the beneficiary reaches the 40% threshold.

Public entities can also be taken to control a discretionary trust if distributions to them meet the 40% control percentage. A public entity is a publicly traded company or unit trust, a mutual insurance company, a mutual affiliate company or a company in which all the shares are beneficially owned by one or more of those entities.

Example

The XY discretionary trust sold a business asset during the year ended 30 June 2004 and made a capital gain. The trust made the following percentage distributions of income and capital for the previous year (there were no distributions of any kind for any of the earlier years, nor did the trust have a tax loss in any previous year):

Percentage distributions of income and capital in 2002–03

Member of trust	Income	Capital
Mr X	50%	-
Mrs X	50%	-
Mr Y	-	50%
Mrs Y	-	50%

As Mr and Mrs X each received at least 40% of the total distributions of income from the trust they each control the trust. As Mr and Mrs Y each received at least 40% of the total distributions of capital from the trust, they also each control the trust.

Example

The Z discretionary trust sold a business asset during the year ended 30 June 2004 and made a capital gain. The trust made percentage distributions of income for the previous 4 years as follows (there were no distributions of capital and no tax losses for any year):

Member of trust	1999-00	2000-01	2001-02	2002-03
Mrs Z	100%	-	25%	20%
Mr Z	-	-	25%	-
Child 1 (<18)	-	25%	25%	40%
Child 2 (<18)	-	25%	25%	40%
Exempt entity	-	50%	-	-

All four prior years need to be examined to identify everyone who controls the trust.

1999-00	Mrs Z controls the trust as she received at least 40% of distributions. Mr Z also controls the trust because distributions to his small business CGT affiliates, eg, his spouse, are added to any distributions he receives to see if the 40% threshold is reached. Mr Z's control percentage is therefore 100%.
2000-01	Mr and Mrs Z each control the trust. Although neither received any distribution, the

	distributions made to each of their small business CGT affiliates (that is, their children under 18 years of age) are included to see if the 40% threshold is reached. Mr and Mrs Z therefore each have a control percentage of 50% and so control the trust. Although the exempt entity received at least 40% of the total distributions, it is not taken to control the trust.
2001-02	Again, Mr and Mrs Z each control the trust. The combined 50% distributions made to their children are added to their own 25% distribution to give them each a control percentage of 100%.
2002-03	Mr and Mrs Z each control the trust. The combined 80% distributions made to their children are added to their own distributions to give Mrs Z a control percentage of 100% and Mr Z 100%. As the children received at least 40% of the total distributions, they are also taken to control the trust.

Accordingly, Mr Z, Mrs Z and each child control the trust.

No distributions made because of tax loss

The trustee of a discretionary trust may nominate up to four beneficiaries as being controllers of the trust for an income year for which the trust had a tax loss and for which the trustee did not pay or apply any income or capital of the trust.

In such a case, the trust might not have had the funds to make a distribution, which would prevent it from being controlled in that year. The trustee may wish to make the nomination to ensure that a particular CGT asset is treated as an active asset for that year.

The nomination must be in writing and signed by the trustee and each nominated beneficiary.

Transitional rules

As noted earlier, there are certain transitional rules that may apply in relation to the changes (reflecting their retrospective nature).

1. **Modification of the new control test for the 2001-02 and prior income years**

The new control test for discretionary trusts is based on actual distributions made for any of the four income years before the year in which the small business CGT concessions are sought.

As a transitional rule (designed to reduce compliance costs), the control test is modified for CGT events happening in the 1999-2000, 2000-01 and 2001-02 income years. For these years, you have to take into account actual distributions made only in the particular year for which the small business concessions are sought. That is, you need to examine only the one year.

Example

The ABC discretionary trust sold a business asset during the year ended 30 June 2002 and made a capital gain. The trust made the following percentage distributions of income and capital for that year:

Percentage distributions of income and capital in 2001–02

Member of trust	Income	Capital
Mr A	50%	-
Mrs A	50%	-
Mr B	-	50%
Mrs B	-	50%

As Mr and Mrs A each received at least 40% of the total distributions of income from the trust, they each control the trust. As Mr and Mrs B each received at least 40% of the total distributions of capital from the trust, they also each control the trust.

It is not necessary to examine the distributions made by the trust for any earlier year to determine if anyone else controls the trust.

2. **Choice for continued operation of former control test**

The new control test applies to CGT events happening after 11.45am, by legal time in the Australian Capital Territory, on 21 September 1999. You can choose a further transitional rule to apply for CGT events that happen before the end of the 2003-04 income year.

In such a case, you can choose to apply the former control test for discretionary trusts (but do not need to take into account assets of potential beneficiaries that are exempt entities or deductible gift recipients). Under the former control test, all potential beneficiaries of a discretionary trust were taken to control the trust regardless of actual distributions (assuming they could potentially receive at least 40% of the total distributions of income or capital).

You must choose to apply the transitional rule by the latest of:

- the day you lodge your income tax return for the income year in which the CGT event happened
- 30 June 2005 (12 months after the date of royal assent), and
- a later day allowed by the Commissioner.

The way you prepare your income tax return is sufficient evidence of making the choice.

You might choose to apply the former control test to enable particular entities to be treated as connected entities so that an asset owned by one entity and used in another entity's business can be an active asset. In this case, the assets of all potential beneficiaries (except exempt entities and deductible gift recipients) must also be included in the trust's $5 million net asset test.

Example

A discretionary trust sold an asset during the year ended 30 June 2004 and made a capital gain. The asset had been used by one of the potential beneficiaries of the trust in a business they carried on. Neither that beneficiary nor any of their small business CGT affiliates had ever received a distribution from the trust.

Under the trust deed, all the potential beneficiaries, including an exempt entity, are capable of receiving 100% of distributions. The trust makes a choice for the former control test to apply.

> Accordingly, all the potential beneficiaries (except the exempt entity) are taken to control the trust and hence are connected with the trust. The asset sold by the discretionary trust can be an active asset because it was used in the business of a connected entity. As well, the assets of all potential beneficiaries (except the exempt entity) must be included in the discretionary trust's $5 million net asset test.

3. **Extension of time to make choices**

The small business CGT concessions require you to make choices. Generally, a choice available under the CGT law must be made by the day you lodge your income tax return for the income year in which the relevant CGT event happened, or within such further time as the Commissioner allows.

A transitional rule applies in relation to CGT events that happen before the date of Royal Assent (29 June 2004) for entities that become eligible to make a choice under the new rules in relation to those events.

In such a case, the transitional rule allows you to make a choice by the latest of:

- the day you lodge your income tax return for the income year in which the CGT event happened
- 30 June 2005 (12 months after the date of royal assent), and
- a later day allowed by the Commissioner.

4. **Extension of time to acquire replacement assets**

Under the small business rollover, you must generally acquire a replacement asset within the period starting one year before and ending two years after the relevant CGT event (or within such further period as the Commissioner allows). As well, the replacement asset must be an active asset when it is acquired, or by the end of two years after the CGT event.

A transitional rule applies in relation to CGT events that happen before the date of Royal Assent (29 June 2004) for entities that become eligible to make a choice under the new rules in relation to those events.

In such a case, the transitional rule extends the period for acquiring the replacement asset and the period within which the asset must be an active asset to the latest of:

- two years after the last CGT event happened in the income year for which the entity obtained the small business rollover
- 30 June 2005 (12 months after the date of royal assent), and
- a later day allowed by the Commissioner.

Connected with - indirect control of an entity

The control tests for the 'connected with' rules are designed to look through business structures that include interposed entities. If an entity (the first entity) directly controls a second entity, and the second entity controls (whether directly or indirectly) a third entity, the first entity is also taken to control the third entity.

A small business entity has a 50% direct interest in Company A, which has a 50% direct and indirect interest in Company B, which in turn has a 30% direct and indirect interest in Company C.

In the above figure, the small business entity controls Companies A and B but not Company C.

Exception where interposed entity is a public entity

The indirect control test does not apply if an entity controls a public entity and that public entity controls a third entity, unless the first entity actually controls the third entity (for example, because it holds 50% of the voting shares of the third entity).

Example

If an entity (E1) controls a public entity (E2) that in turn controls another entity (E3), E1 will not be deemed to control E3 merely because it controls E2. However, E1 will control E3 if, for example, E1 beneficially owns shares that carry a right to 50% of the voting rights in E3.

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Active asset test

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Example

Cessation of a business

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Modified active asset test for CGT event D1

Meaning of active asset

Certain assets cannot be active assets

The active asset test requires the CGT asset that gave rise to the capital gain to be an **active asset**, both at a particular time and for half a particular period.

To satisfy the active asset test, a CGT asset must have been an active asset of yours just before the earlier of:

- the CGT event, and
- when your business ceased - if the CGT event happens within 12 months (or any longer period that the Commissioner allows) of your business ceasing.

Further, the CGT asset must have been an active asset for at least half of the period:

beginning at the later of:

- when you acquired the CGT asset, and
- 15 years before the CGT event or when your business ceased, whichever occurred earlier

and ending at the earlier of:

- the time of the CGT event, and
- when your business ceased.

Broadly, this means that if your business has not ceased and you have owned the asset for less than 15 years, the CGT asset must be an active asset just before the CGT event and for at least half of the period of ownership. If you have owned the asset for more than 15 years, it needs to be an active asset only for at least half of the 15-year period ending at the time of the CGT event (or when the business ceased, if earlier).

The words 'just before' as used in the active asset test mean 'immediately before'. For example, if a business has not ceased, the test requires the CGT asset to be an active asset immediately before the CGT event. If the asset stops being an active asset shortly before it is sold, it will not satisfy the active asset test.

Example

Laura, a sole trader, carried on business from premises she owned. The premises had been used only for business purposes. Due to expansion of the business, Laura vacated the premises and moved into larger premises across the street. Shortly after moving, Laura entered into a contract to sell the original premises.

In this case, immediately before their sale, the premises were not used, or held ready for use, in Laura's business (because Laura had moved to other premises). Accordingly, the premises were not an active asset 'just before' the CGT event (sale of the premises) and therefore do not satisfy the active asset test. The small business CGT concessions are not available in this situation.

Cessation of a business

For the purposes of the active asset test, the cessation of a business includes the sale of a business. That is, it is not limited to a business that ends in the sense that no-one continues to carry it on but also includes a business that has ceased to be carried on by an entity because the entity has sold that business.

This aspect of the active asset test allows some flexibility in the situation where a business is sold, or has otherwise ceased, and an asset previously used in the business is sold after that time. As the asset would no longer be an active asset after the business ceases, it would fail the 'just before the CGT event' part of the test. The 'just before cessation of the business' alternative allows an asset that was used in the business up until the time of the sale of the business to satisfy the active asset test if the other aspects of the test are also satisfied.

For the cessation of the business alternative to apply, the CGT event must happen within 12 months of the business ceasing or any longer period the Commissioner allows. If the CGT event happens outside the 12-month period, you need to seek an extension of time from the Commissioner. Extension of time requests are considered on the merits of each case.

Example

Jane carried on a business from premises she owned. In June 2003 she sold the business but retained ownership of the premises. In December 2003 Jane sold the premises and made a capital gain. As Jane sold the premises within 12 months of selling the business and the premises were an active asset just before the sale of the business, the premises can satisfy the active asset test if the other aspects of the test are also satisfied.

Asset devolved to legal personal representative

If a person carrying on a business dies and their assets devolve to their legal personal representative, the active asset test is applied to the legal personal representative in relation to any capital gain made on a sale of the assets by the legal personal representative.

Example

Arthur carried on a business for many years from premises he owned. In 2002 he died and the business ceased at that time. Six months later, the legal personal representative of Arthur's estate sold the premises and made a capital gain.

As it was the legal personal representative who made the capital gain, the active asset test was applied to them. In this situation, the premises were not an active asset (that is, used in a business) of the legal personal representative just before their sale because the legal personal representative did not continue to carry on the deceased's business. As well, the premises were not an active asset of the legal personal representative just before the business ceased because at that time they were not an asset of the legal personal representative at all (but were still owned by Arthur).

Accordingly, the business premises did not satisfy the active asset test in relation to the capital gain made by the legal personal representative when they sold the premises.

Continuing time periods for active asset test for involuntary disposals

There are modified rules to determine if the active asset test is satisfied for CGT assets acquired or transferred under the rollover provisions relating to assets compulsorily acquired, lost or destroyed or to marriage breakdown (Subdivisions 124-B and 126-A of the ITAA 1997 respectively).

If you acquired a replacement asset to satisfy the rollover requirements for the compulsory acquisition, loss or destruction of a CGT asset, the replacement asset is treated as if:

- you acquired it when you acquired the original asset, and
- it was an active asset at all times when the original asset was an active asset.

If you have a CGT asset transferred to you because of a marriage breakdown, and the capital gain arising from that transfer was rolled over under the marriage breakdown rollover provisions, for purposes of the active asset test you can choose whether to:

- include the ownership and active asset periods of your former spouse, or
- commence the ownership and active asset periods from the time the asset was transferred to you.

If you choose to include your former spouse's ownership and active asset periods of the CGT asset, that asset is treated as if it had been:

- acquired by you when your former spouse acquired the asset, and
- an active asset of yours at all times when the asset was an active asset of your former spouse.

Modified active asset test for CGT event D1

A modified active asset test applies if you make a capital gain from CGT event D1 (about creating rights in another entity). The active asset test requires you to own the CGT asset before the CGT event happens. However, under CGT event D1, the relevant CGT asset (the rights) are created in the other entity without you owning them so it would not be possible to satisfy the active asset test.

Accordingly, the test is modified to require the right you create that triggers the CGT event to be inherently connected with another CGT asset of yours that satisfies the active asset test.

Meaning of active asset

A CGT asset is an **active asset** if it is owned by you and is:

- used or held ready for use by you, your small business CGT affiliate, or an entity connected with you, in the course of carrying on a business, or
- an intangible asset that is inherently connected with a business you carry on, for example, goodwill.

An intangible asset you own that is used, or held ready for use, in the course of carrying on a business by your small business CGT affiliate or an entity connected with you may also be an active asset.

Example

Hagar carries on an ocean cruise business called North Sea Adventures. He purchased waterfront land on 1 January 1990 but initially used it for family holidays and not in the business. On 1 January 1994 Hagar started using the land in the business for launching his boats and carrying out necessary repairs and maintenance. He continued to do so until 1 January 2000, when he sold the land and made a capital gain.

The land satisfies the active asset test as it was used in Hagar's business just before he disposed of it and for at least half the period he owned it, that is, for six out of the 10 years he owned it.

Shares and trust interests may also be active assets

A CGT asset is also an active asset at a given time if you own it and:

- it is either a share in a company that is an Australian resident at that time or an interest in a trust that is a resident trust for CGT purposes for the income year in which that time occurs, and
- the total of
  - the market values of the active assets of the company or trust, and
  - any capital proceeds the company or trust received during the two years before that time from CGT events happening to active assets the company or trust holds in the form of cash or debt pending the acquisition of new active assets

  is 80% or more of the market value of all the assets of the company or trust.

This means a share in a company or an interest in a trust is an active asset if the company or trust itself has active assets with a market value of at least 80% of the market value of all its assets. Including capital proceeds from any recent sale of active assets in the 80% test provides some flexibility where the total market value of the active assets of the company or trust temporarily drops below 80% between the time active assets are sold and new active assets acquired.

The active asset test requires a CGT asset to have been an active asset for at least half of a particular period, as outlined earlier. For example, for a share in an Australian resident company to meet this requirement, the company must satisfy the 80% test for that same period.

Example

Jack and Jill are the only shareholders of Hill Water Supplies Pty Ltd, an Australian resident company that carries on a water supply business. The market values of the company's CGT assets are as follows:

Business premises	$400,000
Goodwill	$100,000
Trading stock	$100,000
Plant	$300,000
Rental property (not an active asset)	$100,000
Total	**$1,000,000**

The total market value of the company's active assets is $900,000 which is more than 80% of the total market value of all the company's assets. Jack and Jill's shares in the company are therefore active assets.

The company sells its water filtration plant (for its market value of $200,000) and then immediately contracts to purchase new plant, which is delivered and installed two months later. The funds from the sale are held in the company's bank account before being used to pay for the new plant.

In this situation, although the market value of the company's active assets may drop below the 80% mark, the $200,000 capital proceeds held in the form of debt pending the acquisition of the new plant are included in the calculation. This means the 80% test is satisfied.

Although gains from depreciating assets may be treated as income rather than capital gains, depreciating assets such as plant are still CGT assets and may therefore be active assets and included in the 80% test.

Interests in holding entities

An interest in an entity that itself holds interests in another entity that operates a business may be an active asset depending on the successive application of the 80% test at each level.

Example

Ben owns 100% of the shares in Holding Co which, in turn, owns 100% of the shares in Operating Co (both are resident companies). The only assets of Holding Co are the shares in Operating Co and all of Operating Co's assets are active assets.

As Operating Co satisfies the 80% test, the shares owned by Holding Co in Operating Co are active assets. As those shares are the only assets owned by Holding Co, Holding Co also satisfies the 80% test and therefore the shares owned by Ben in Holding Co are also active assets.

If Ben sold the shares in Holding Co, all the small business concessions may potentially apply to any gains made. However, if Holding Co sold its shares in Operating Co, none of the concessions can apply because Operating Co does not have a controlling individual. Also, if Operating Co sold its active assets, only the 50% active asset reduction and the small business rollover can apply, again because Operating Co does not have a controlling individual. For more information see the **controlling individual** requirements.

Certain assets cannot be active assets

The following CGT assets cannot be active assets (even if they are used, or held ready for use, in the course of carrying on a business):

- shares in companies or interests in trusts, other than those that satisfy the 80% test outlined above
- financial instruments, such as loans, debentures, bonds, futures and other contracts and share rights and options, or

- assets whose main use is to derive interest, an annuity, rent, royalties or foreign exchange gains (unless the main use for deriving rent was only temporary or the asset is an intangible asset that you have substantially developed or improved so that its market value has been substantially enhanced).

Financial instruments exception

Other examples of financial instruments include bank accounts and Australian currency.

The main effect of these items not being active assets is that, generally, they can not be included in the 80% test when determining whether shares in companies or interests in trusts are active assets. However, as noted earlier, there is an exception if the funds in a bank account or Australian currency on hand (that is, debt or cash):

- represent capital proceeds received in the previous two years from CGT events happening to active assets, and
- are held pending the acquisition of new active assets.

Main use to derive rent exception

As already noted, an asset whose main use is to derive rent (unless that main use is only temporary) cannot be an active asset. This is so even if the asset is used in the course of carrying on a business. Of course, if the activities carried on do not amount to carrying on a business, you do not need to even consider whether the main use of the asset is to derive rent. You therefore must firstly determine whether a business is being carried on.

Whether an asset's main use is to derive rent will depend on the particular circumstances of each case. The term 'rent' has been described as referring to the payments made by a tenant/lessee to a landlord/lessor for exclusive possession of the leased premises. As such, a key factor in determining whether an occupant of premises is a lessee paying rent is whether the occupier has a right to exclusive possession. If, for example, premises are leased to a tenant under a lease agreement granting exclusive possession, the payments involved are likely to be rent and the premises are not an active asset. On the other hand, if the arrangement allows the person only to enter and use the premises for certain purposes and does not amount to a lease granting exclusive possession, the payments involved are not likely to be rent.

Example

Rachael owns five investment properties which she rents to tenants under lease agreements that grant exclusive possession. The lease terms vary from six months to two years. The properties are not active assets because they are mainly (only) used by Rachael to derive rent. It is irrelevant whether Rachael's activities constitute a business.

Example

Michael owns a motel (land and buildings) which he uses to carry on a motel business. The motel provides room cleaning, breakfast, in-house movies, laundry and other services as part of the business. Guests staying in the motel do not receive exclusive possession but simply have a right to occupy a room on certain conditions. The usual length of stay by guests is between one and seven nights. The motel would be an active asset because its main use is not to derive rent.

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Controlling individual test

Last updated 10 September 2007

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If your CGT asset is a share in a company or an interest in a trust, the company or trust must satisfy the controlling individual test for you to qualify for any of the concessions. As well, some of the concessions require a company or trust to have a controlling individual regardless of the type of CGT asset involved.

A company or trust satisfies the controlling individual test if it had at least one controlling individual just before the CGT event. The small business 15-year exemption further requires a company or trust to have a controlling individual for the entire period of ownership of the CGT asset.

The controlling individual test is not the same as the control tests used to determine if an entity is 'connected with' another entity for the purposes of the $5 million maximum net asset value test.

Meaning of controlling individual

The following section explains who is a controlling individual for a company, fixed trust and a discretionary trust.

Companies

An individual is a **controlling individual** of a company if the individual holds legal and equitable interests in shares (apart from redeemable shares) that carry between them:

- the right to exercise at least 50% of the voting power in the company, and
- the right to receive at least 50% of any distribution of income and capital that the company may make.

Example

Joe owns shares carrying 60% of the voting and distribution rights in Company X. Joe is a controlling individual of the company. If Joe actually owned 50% and his wife Anne owned 50%, they would both be controlling individuals of the company.

Alternatively, if Joe and Anne owned 40% each and their daughter Clare owned the remaining 20% there would be no controlling individuals and the company would not satisfy the controlling individual test.

If a company has no individual shareholders, for example, if all the shareholders are trusts or companies, it does not have a controlling individual.

If an individual holds interests in a company indirectly through one or more interposed entities, the controlling individual requirement is not satisfied.

Example

Operating Co carries on business. Holding Co holds 100% of the shares in Operating Co. Frank owns 100% of the shares in Holding Co.

Operating Co does not have a controlling individual. This is because no individual holds the legal and equitable interests in shares that carry the right to exercise at least 50% of the voting power and receive at least 50% of any income or capital distributions.

Different share classes

If a company has different share classes, all classes must be taken into account (apart from redeemable shares) to determine if the company has a controlling individual. As the following examples illustrate, the existence of a directors' discretion to distribute to one class of shares instead of another is likely to critically affect whether the company has a controlling individual.

Example

A company has two different classes of shares, A and B, which have equal distribution rights. Only the A class shares have voting rights. Each class of shares is held by different shareholders - the A class shares being held in equal proportion by Fred and Barney and the B class shares being held in equal proportion by their respective wives, Wilma and Betty.

The directors can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares. There is the possibility of any of the shareholders receiving 50% of a distribution from the company, depending on the exercise of the directors' discretion.

In this situation, the company does not have a controlling individual. There is no specific individual who holds shares that carry between them the right to receive at least 50% of any distribution the company may make. Fred and Barney (who each hold 50% of the voting power) might receive 50% of a distribution or they might not receive anything at all, depending on how the directors exercise their discretion.

Example

A company has two different classes of shares, A and B, which have equal voting and distribution rights. Isaac holds 50% of the shares of each class. The directors can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares.

In this situation, the company does have a controlling individual. As Isaac holds 50% of the shares of each class, he can exercise at least 50% of the voting power and, regardless of how the directors' discretion is exercised, Isaac will always receive 50% of any distribution made by the company.

Example

A company has only A class shares apart from one D class share issued to a key employee. Gus holds 50% of the A class shares which have full voting and distribution rights. The D class share has dividend rights only payable at the discretion of the directors.

In this situation, the company does not have a controlling individual. Gus may receive 50% of a distribution if the directors do not exercise their discretion to make part of the distribution to the D class shareholder, but he will receive less than 50% of the distribution if the discretion is exercised. That is, Gus does not hold shares that carry between them the right to receive at least 50% of any distribution made. His 'notional' 50% interest is reduced to below 50% because of the directors' ability to make distributions to the D class shareholder.

Fixed trusts

An individual is a **controlling individual** of a fixed trust (for example, a unit trust) if the individual is beneficially entitled to at least 50% of the income and capital of the trust.

If a fixed trust has no individual beneficiaries (for example, if all the beneficiaries are trusts or companies) it does not have a controlling individual.

If an individual holds interests in a fixed trust indirectly through one or more interposed companies or trusts, the controlling individual requirement is not satisfied.

Example

A unit trust carries on a business. There are two unit holders that are discretionary trusts, each being entitled to 50% of the income and capital of the unit trust. Each of the discretionary trusts has individual beneficiaries.

In this situation, the unit trust does not have a controlling individual because it has no individual beneficiaries and, accordingly, does not satisfy the controlling individual test. It is therefore not eligible for the small business 15-year exemption or the small business retirement exemption.

The unit trust may be eligible for the small business 50% active asset reduction and the small business rollover if the other conditions are satisfied.

Discretionary trusts

An individual is a **controlling individual** of a discretionary trust during an income year if:

- the trust made a distribution of income or capital, or both, during that year, and
- the individual was beneficially entitled to at least 50% of the total income distributions and at least 50% of the total capital distributions made by the trust in that year.

If a discretionary trust did not make any distributions of income or capital during an income year, the trust would not have a controlling individual for that year, and therefore would not satisfy the controlling individual test.

However, for the purposes of the small business 15-year exemption only, the requirement that there be a controlling individual for the whole of a particular ownership period does not apply for an income year in which a discretionary trust did not make a distribution of income or capital if the trust had a tax loss for that income year. But there must still be a controlling individual just before the CGT event.

Meaning of CGT concession stakeholder

If your CGT asset is a share in a company or an interest in a trust, you must also be a CGT concession stakeholder of the company or trust to qualify for any of the concessions.

If a company or trust has claimed the small business 15-year exemption or the small business retirement exemption, a CGT concession stakeholder may receive an exempt amount from the company or trust if the conditions are satisfied.

To be a ***CGT concession stakeholder*** of a company or trust you must be:

- a controlling individual of the company or trust, or
- a spouse of a controlling individual if
  - for a company, the spouse holds legal and equitable interests in any amount of shares in the company
  - for a fixed trust such as a unit trust, the spouse is beneficially entitled to any of the income or capital of the trust, or

- for a discretionary trust, during the income year the trust made a distribution of income or capital to which the spouse was beneficially entitled.

A company or trust will have two, one or no CGT concession stakeholders. It will not have a CGT concession stakeholder if it does not have a controlling individual. For example, in the case of three brothers having equal interests in a company or trust, there are no CGT concession stakeholders because there are no controlling individuals.

Example

There are 100 issued shares in Company X, all with equal voting and distribution rights. Joe owns 99 shares and his wife Anne owns one share. Joe is a controlling individual of the company and, because Anne is his spouse and owns a share in the company, they are both CGT concession stakeholders. Anne and Joe may be entitled to the small business concessions when they sell their shares.

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Small business 15-year exemption

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Interaction with other concessions

Conditions to be satisfied

The rules covering the small business 15-year exemption are contained in Subdivision 152-B of the Income Tax Assessment Act 1997.

Interaction with other concessions

If you qualify for the small business 15-year exemption, you can entirely disregard the capital gain and do not need to apply any other concessions. Further, you do not have to apply capital losses against your capital gain before applying the 15-year exemption.

If the conditions are satisfied and a capital loss is made from the CGT event, you may use the capital loss to reduce other capital gains.

Conditions to be satisfied

You can disregard a capital gain from a CGT event happening to a CGT asset you have owned for at least 15 years if you satisfy the basic conditions for the small business CGT concessions

The active asset test requires the asset to have been an active asset for at least half of the relevant 15-year period and not half of the full period of ownership.

- continuously owned the CGT asset for the 15-year period ending just before the CGT event happened
- are an individual who is
  - at least 55 years old at the time of the CGT event and the event happens in connection with your retirement, or
  - permanently incapacitated at the time of the CGT event
- are an individual and the CGT asset is a share in a company or an interest in a trust and that company or trust had a controlling individual for the entire time you owned the share or interest (even if it was not the same controlling individual during the whole period), and
- are a company or trust, and had a controlling individual for the entire time you owned the CGT asset (even if it was not the same controlling individual during the whole period), and the individual who was a controlling individual just before the CGT event was
  - at least 55 years old at that time and the event happened in connection with their retirement, or
  - permanently incapacitated at that time.

Example

Ruth and Geoff are partners in a partnership that conducts a farming business on land they purchased in 1986 and have owned continuously since that time. The net value of their CGT assets for the purpose of the maximum net asset value test is less than $5 million.

Ruth and Geoff wish to retire as they are both over 60 years of age. As they have no children, they decide to sell the major asset of the farming business (the land). They sell the land in 2002, for a total capital gain of $100,000. Both Ruth and Geoff qualify for the small business 15-year exemption in relation to the capital gain.

Exception for discretionary trusts with tax losses

In relation to the controlling individual requirement, there is an exception for discretionary trusts that have tax losses in an income year. The requirement that there be a controlling individual for the whole of a period does not apply to an income year in which a discretionary trust did not make a distribution of income or capital if the trust had a tax loss for that income year. This is because the trust might not have had the funds to make a distribution during that income year, which would prevent it from having a controlling individual in that year.

This exception applies only for the small business 15-year exemption and not for any of the other small business concessions. Further, there must still be a controlling individual just before the CGT event, so this exception does not apply in the year the CGT event happens.

In connection with an individual's retirement

Whether a CGT event happens in connection with an individual's retirement depends on the particular circumstances of each case. The following examples provide a guide as to the likely scope of the term.

The first example indicates where the CGT event **would** be 'in connection with retirement' for the purposes of the 15-year exemption:

Example

A small business operator, aged over 55, sells his business. Under the terms of the sale, he agrees to be employed by the new owner for a few hours each week for two years. The sale of the business would be in connection with the small business operator's retirement. He has permanently or indefinitely ceased being self-employed and has commenced gainful employment on a much reduced scale with another party, although still performing similar activities.

On the other hand, the following example indicates where the CGT event **would not** be 'in connection with retirement':

Example

A small business operator and spouse are both pharmacists, are both aged over 55 and carry on business through two pharmacies. They sell one (and make a capital gain) and, accordingly, reduce their working hours from 60 hours a week each to 45 and 35 hours a week respectively. So there has been some change to their present activities in terms of hours worked and location. But there has not been a significant reduction in the number of hours or a significant change in the nature of their activities and therefore there has been no 'retirement'.

If, on the other hand, one spouse reduced their hours to nil and stopped working, there would be a significant reduction in the number of hours (that is, to nil) that spouse was engaged in the business activities. The sale would be in connection with the retirement of that spouse.

A CGT event may be 'in connection with your retirement' even if it occurs at some time *before* retirement. Whether particular cases satisfy the conditions depends very much on the facts of each case, but here is an example.

Example

A small business operator, aged over 55, sells some business assets as part of a wind down in business activity ahead of selling the business. Within six months she sells the business and ends her present activities. If it can be shown that the earlier CGT event was integral to the business operator's plan to cease her activities and retire, the CGT event may be accepted as happening in connection with retirement.

Similarly, the words 'in connection with' can apply where the CGT event occurs sometime **after** retirement. Again, this type of case would depend on its own particular facts and cases would need to be considered on a case-by-case basis, but here is an example.

Example

A small business operator 'retires' and his children take over the running of the business. Within six months, some business assets are sold and a capital gain is made. Several reasons may have prompted the sale of the assets. If there is no relevant connection with the small business operator's business, the requirement would not be satisfied. If it can be shown that the reason for disposing of the assets is connected to retirement and the later sale is integral to the small business operator's retirement plan, the sale may be accepted as happening in connection with retirement.

Permanent incapacity

Whether an individual is permanently incapacitated at the time of the CGT event depends on the particular circumstances of each case. The following example provides an indication of the meaning of the term for the purposes of the small business 15-year exemption.

Example

Jack had been carrying on business for many years. Unfortunately, he developed severe health problems that continued to deteriorate to the point where he was incapable of operating the business and, as a result, he sold the business.

At the time the business was sold, Jack's doctor provided a written statement that Jack suffered ill health to the extent that he was unlikely to be able to engage again in gainful employment for which he was reasonably qualified. Jack was under 55 years of age when he sold the business.

Having regard to all the circumstances, Jack would be considered to be permanently incapacitated at the time the business was sold. He may therefore qualify for the small business 15-year exemption if he satisfies the other conditions.

Continuing time periods for the exemption for involuntary disposals

A requirement of the small business 15-year exemption is that you must have continuously owned the CGT asset for at least 15 years before the CGT event. However, there are modified rules to determine if this requirement is satisfied for CGT assets acquired or transferred under the rollover provisions relating to assets compulsorily acquired, lost or destroyed, or to marriage breakdown (Subdivisions 124-B and 126-A of the *Income Tax Assessment Act 1997* respectively).

If you acquired a replacement asset to satisfy the rollover requirements in respect of the compulsory acquisition, loss or destruction of a CGT asset, the replacement asset is treated as if you acquired it when you acquired the original asset.

If you have a CGT asset transferred to you because of a marriage breakdown, and the capital gain arising from that transfer was rolled over under the marriage breakdown rollover provisions, for the purpose of determining whether the 15-year requirement has been satisfied you can choose to:

- include the ownership period of your former spouse, or
- commence the ownership period from the time the asset was transferred to you.

If you choose to include your former spouse's ownership period of the CGT asset, that asset is treated as if you acquired it when your former spouse acquired the asset.

Example

Cameron and Therese were married for 10 years, during which time Cameron owned a farm on which he operated a dairy business. Since their divorce, Therese has owned the farm (it was transferred to her in circumstances under which Cameron obtained a rollover under the marriage breakdown rollover provisions) and operated the dairy business for the past five years.

Therese can sell the farm and obtain the 15-year exemption (if she is 55 or over and sells the farm to retire or is incapacitated) if she chooses to adopt Cameron's ownership and active asset periods.

Separate interests in the same CGT asset

If you own separate interests in the same CGT asset and sell those interests together, the 15-year exemption applies only to interests in the asset that you have owned continuously for at least 15 years. The exemption does not apply to any interest you have owned for less than 15 years. This is because interests in an asset acquired at different times are separate CGT assets.

Example

On 1 December 1985 Janet purchased a 40% interest in a 400-hectare parcel of grazing land. On 1 December 1990 she purchased the remaining 60% interest in the land. On 15 December 2003 (Janet's 60th birthday) Janet sold the land and retired.

While Janet owned the 40% interest she purchased in 1985 for at least 15 years, she owned the 60% interest she purchased in 1990 for just over 13 years. The two interests are separate CGT assets and, accordingly, the capital gain made on the sale of the 60% interest is not eligible for the 15-year exemption (it may be eligible for other CGT concessions).

Consequences of applying the exemption

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Consequences of applying the exemption

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[Distributions of the exemption amount]

[Impact on superannuation benefits]

Distributions of the exemption amount

If a capital gain made by a company or trust is disregarded under the small business 15-year exemption, or would have been except that the capital gain was disregarded anyway because the relevant CGT asset was acquired before 20 September 1985, any distributions made by the company or trust of that exempt amount to a CGT concession stakeholder is:

- not included in the assessable income of the CGT concession stakeholder, and
- not deductible to the company or trust

if certain conditions are satisfied.

The conditions are:

- the company or trust must make a payment within two years after the CGT event that resulted in the capital gain
- the payment must be made to an individual who was a CGT concession stakeholder of the company or trust just before the CGT event, and
- the total payments made to each CGT concession stakeholder must not exceed an amount determined by multiplying the CGT

concession stakeholder's control percentage by the exempt amount.

The **stakeholder's control percentage** is:

- for a company, the percentage of the legal and equitable interests in shares (other than redeemable shares) in the company that carry voting and distribution rights held by the CGT concession stakeholder just before the CGT event
- for a fixed trust, the percentage of the income and capital of the trust to which the CGT concession stakeholder was beneficially entitled just before the CGT event, or
- for a discretionary trust
  - 100% if there was one CGT concession stakeholder just before the CGT event, or
  - 50% each if there were two CGT concession stakeholders just before the CGT event.

Example

Joe is a controlling individual of Company X, owning 60% of the shares in the company. Joe's wife Anne owns the remaining 40% of shares in the company. The company makes a capital gain of $10,000, which it can disregard under the small business 15-year exemption as Joe is 56 and both Joe and Anne are planning to retire.

Six months after the CGT event, the company distributes the amount of the exempt capital gain to the shareholders. As CGT concession stakeholders, Joe and Anne both qualify for the small business 15-year distribution exemption. The amount that is exempt is calculated as follows:

For Joe: 60% of $10,000 = $6,000

For Anne: 40% of $10,000 = $4,000

If it is decided to distribute $8,000 each to Joe and Anne, they can exclude from their assessable incomes for the income year an amount of $6,000 and $4,000 respectively. The balance is likely to be assessable as a dividend.

Example

The beneficiaries of the M family discretionary trust are the members of the M family and two employees of the family business carried on by the trustee of the trust. Mrs M and Mr M are the controlling individuals of the discretionary trust, and are therefore CGT concession stakeholders. Their three children are treated as small business affiliates.

The trustee of the trust sells a CGT asset of the business and makes a capital gain of $50,000. The gain qualifies for the small business 15-year exemption as Mr M is 58 and plans to retire from the family business. In the next income year the trustee distributes that amount equally to Mrs M and Mr M and to the three children.

As CGT concession stakeholders, Mrs M and Mr M are each able to treat the distribution of $10,000 as an exempt amount. Their three children must include the distribution in their assessable income for the year.

Impact on superannuation benefits

A distribution of an exempt amount does not affect an individual's superannuation reasonable benefit limit.

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Small business 50% active asset reduction

Last updated 3 February 2024

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The rules covering the small business 50% active asset reduction are contained in **Subdivision 152-C of the Income Tax Assessment Act** 1997..

Interaction with other concessions

If you do not qualify for the small business 15-year exemption, the small business 50% active asset reduction may apply to reduce the capital gain.

Unlike the other small business concessions, the small business 50% active asset reduction applies automatically if the basic conditions are satisfied, unless you choose for it not to apply.

For example, you might prefer for it not to apply and instead choose the small business retirement exemption or the small business rollover. Making this choice might allow a company or trust to make larger tax-free eligible termination payments under the small business retirement exemption.

Otherwise, the small business retirement exemption or the small business rollover (or both) may apply to the capital gain that remains after applying the small business 50% active asset reduction.

Conditions to be satisfied

To apply the small business 50% active asset reduction, you only need to satisfy the basic conditions. There are no further requirements.

Consequences of applying the reduction ›

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Consequences of applying the reduction

Last updated 10 September 2007

If you satisfy the basic conditions, the capital gain that remains after applying:

- any current year capital losses and any unapplied prior year net capital losses, and
- the CGT discount (if applicable)

is reduced by 50%.

This means that if you are an individual or a trust and you have applied the CGT discount and the small business 50% active asset reduction, the capital gain (after being reduced by any capital losses applied against it) is effectively reduced by 75% (that is, 50% then 50% of the remainder).

Example

Lana operates a small manufacturing business and disposes of a CGT asset that she has owned for three years and has used as an active asset of the business. She makes a capital gain of $17,000 from the CGT event, and qualifies for the CGT discount and for the small business 50% reduction. Lana also has a capital loss in the income year of $3,000 from the sale of another asset. She calculates her net capital gain for the year as follows:

$17,000 – $3,000	$14,000
$14,000 – (50% × $14,000)	$7,000
$7,000 – (50% × $7,000)	$3,500

Her net capital gain for the year is $3,500 (assuming the small business retirement exemption and the small business rollover do not apply). If Lana chooses the rollover or the retirement exemption some or all of the remaining capital gain would be disregarded.

Rules for beneficiaries of trusts

The rules for beneficiaries of trusts are contained in Subdivision 115-C of the ITAA 1997.

If a trust makes a capital gain, its net capital gain for the income year is generally calculated in the same way as for other entities, by reducing any capital gains firstly by any capital losses and then by any relevant concessions. The net capital gain is included in the net income of the trust. Presently entitled beneficiaries of the trust are assessed on their share of the net income of the trust, which includes a share of the trust's net capital gain.

There are special rules that enable concessions obtained by a trust to be passed on to the beneficiaries of the trust who are presently entitled to a share of the trust's income.

A beneficiary must gross up their share of any capital gain received from a trust by:

- multiplying that amount by 2, if the trust has applied either the CGT discount or the small business 50% active asset, or
- multiplying that amount by 4, if the trust has applied **both** the CGT discount and the small business 50% active asset reduction.

The beneficiary's share of the trust capital gains (grossed up if required) is then taken into account in the method statement for calculating the beneficiary's net capital gain to be included in their assessable income:

- the trust capital gains are firstly reduced by any capital losses of the beneficiary, and
- any trust capital gain remaining is then reduced by the CGT discount (if the beneficiary is a type of entity eligible for the CGT discount - see below) and/or the small business 50% active asset reduction if the trust's capital gain was reduced by those concessions to arrive at the beneficiary's net capital gain.

A corporate beneficiary of a trust must gross up as above their share of any net capital gains received from a trust that have been reduced (by the trust) by the CGT discount but is not entitled to reduce this grossed-up amount by the CGT discount because companies are ineligible for the CGT discount.

The grossed-up capital gain is in addition to the beneficiary's share of the trust's net capital gain that is included in their share of the net income of the trust. Accordingly, the beneficiary is entitled to a deduction for that part of their share of the net income of the trust that is attributable to the trust's net capital gain.

Example

A unit trust makes a capital gain of $100,000 when it disposes of an active asset. The trust has no capital losses. If all the conditions for the CGT discount and the small business 50% active asset reduction are satisfied the trust's net capital gain is $25,000 (no other concessions apply).

Assume there is one individual beneficiary presently entitled to the net income of the trust. The beneficiary also has a separate capital loss of $10,000.

The beneficiary works out their net capital gain as follows:

> Share of net capital gain: $25,000

Gross up this amount by multiplying by 4:

> $25,000 × 4 = $100,000

Deduct capital losses: $10,000

> $100,000 − $10,000 = $90,000

Apply 50% CGT discount:

> $90,000 × 50% = $45,000

Apply 50% reduction:

> $45,000 × 50% = $22,500

Net capital gain: $22,500

Distributions to beneficiary of a fixed trust of amount to which small business 50% active asset reduction applied

If a beneficiary's interest in a trust is fixed (for example, an interest in a unit trust), there are rules to deal with the situation where the trust distributes to the beneficiary an amount of capital gain that was excluded from the trust's net income because it claimed the small business 50% active asset reduction.

The payment of the amount will firstly reduce the cost base of the beneficiary's interest in the trust. If the cost base is reduced to nil, a capital gain may arise in respect of the beneficiary's interest in the trust. This capital gain may qualify for the CGT discount (after applying any capital losses) if the interest in the trust has been owned by the beneficiary for at least 12 months.

If a beneficiary's interest in a trust is not fixed (for example, the trust is a discretionary trust), there are no CGT consequences for the beneficiary.

QC 27357

Small business retirement exemption

Last updated 10 September 2007

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[Conditions to be satisfied]

The rules covering the small business retirement exemption are contained in Subdivision 152-D of the Income Tax Assessment Act 1997.

Interaction with other concessions

You may choose to disregard all or part of a capital gain under the small business retirement exemption if you satisfy certain conditions.

This concession interacts with the eligible termination payment (ETP) provisions. Broadly, it requires amounts to be paid (rolled over) into a complying superannuation fund, a complying approved deposit fund or a retirement savings account under the ETP provisions if the recipient is younger than 55.

You may choose to apply the small business retirement exemption:

- after the small business 50% active asset reduction - that is, to the remaining 50% (or if the CGT discount has also applied, the remaining 25%) of the capital gain after capital losses have been applied, or
- instead of the small business 50% active asset reduction - that is, to the capital gain that remains after you have applied any CGT discount and capital losses. Making this choice might allow a company or trust to make larger tax-free ETPs under the small business retirement exemption.

You may instead choose the small business rollover if its conditions are satisfied or you may choose both concessions for different parts of the remaining capital gain.

Conditions to be satisfied

Individual

If you are an individual, you can choose to disregard all or part of a capital gain if:

- you satisfy the basic conditions
- you keep a written record of the amount you chose to disregard (the CGT exempt amount)
- if you were under 55 years of age just before you received an amount of capital proceeds from the CGT event, you roll over an amount equal to the exempt amount under the ETP provisions. (If you were 55 or older, there is no requirement to roll over any amount).

If you choose an amount to disregard under the small business retirement exemption, the capital proceeds from the CGT event (to the extent of the exempt amount) are taken to be an ETP paid to you at the later of when you made the choice and when you received the capital proceeds.

Therefore, if you choose the retirement exemption after you have received the capital proceeds (for example, when you lodge your income tax return) you are not required to rollover any amount until you make the choice. Accordingly, you may use the capital proceeds for other purposes before making the choice. However, once you make the choice you must immediately roll over an amount equal to the ETP if you were under 55 just before you received the capital proceeds.

To satisfy the immediate rollover requirement you must pay the amount into a complying superannuation (or similar) fund no later than the day you choose the retirement exemption.

This is an important requirement. Failure to immediately roll over the amount in accordance with the ETP provisions will mean the conditions are not satisfied and the retirement exemption will not be available.

Taxation Determination TD 96/36 further discusses the circumstances in which an ETP will be accepted as having been 'immediately' paid to a rollover fund. However, the circumstances referred to in the Determination that might give rise to a further period being allowed to make the rollover do not arise where an amount is deemed to be an ETP in the individual's hands.

Company or trust

If you are a company or trust, other than a public entity, you can also choose to disregard all or part of a capital gain if:

- you satisfy the basic conditions
- you satisfy the controlling individual test
- you keep a written record of the amount you choose to disregard (the exempt amount) and, if there are two CGT concession stakeholders, each stakeholder's percentage of the exempt amount (one may be nil but together they must add up to 100%)
- you make an ETP in relation to each of your CGT concession stakeholders, worked out by reference to each individual's percentage of the exempt amount

- the ETPs are made by the later of
  - seven days after you choose to disregard the capital gain
  - seven days after you receive the capital proceeds from the CGT event

- if a stakeholder is under 55 years of age just before receiving the ETP, an amount equal to that payment must be immediately rolled over under the ETP provisions. (If the stakeholder was 55 or more there is no requirement to roll over the amount.)

Therefore, if you choose the retirement exemption after you have received the capital proceeds (for example, when you lodge your income tax return) there is no requirement to make any ETPs until you have made the choice. Accordingly, you may use the capital proceeds for other purposes before choosing. However, once you choose, you must make the ETPs by the end of seven days after making the choice.

If a stakeholder is under 55 just before receiving an ETP, an amount equal to that ETP must be immediately rolled over, that is, paid to a complying superannuation (or similar) fund.

This is an important requirement. Failure to immediately rollover an ETP into a complying superannuation (or similar) fund in accordance with the ETP provisions will mean the conditions are not satisfied and the retirement exemption will not be available. Generally, to satisfy the immediate roll over requirement, the funds need to be transferred direct from the payer of the ETP to the nominated fund and it is only in certain circumstances that a transfer of the funds direct to a stakeholder before being transferred to the nominated fund will be accepted as satisfying the requirement.

For more information on the circumstances in which an ETP is accepted as having been immediately rolled over see Taxation Determination TD 96/36.

Termination of employment required

As already stated, a company or trust choosing the retirement exemption must make an actual ETP in relation to each of its CGT concession stakeholders. This means that the payment must qualify as an ETP under the ETP provisions. That is, it must be a payment made in respect of the stakeholder in consequence of the termination of any employment of the stakeholder.

As 'employment' includes the holding of an office, this part of the requirement is satisfied (for a company) if the stakeholder resigns/retires in a bona fide manner either as an employee or as a director. If there is no termination of any employment, the retirement exemption cannot be chosen.

For an individual choosing the retirement exemption there is no requirement to terminate any activity or cease their business. This is because there is no requirement to make an actual ETP. Rather, the exempt amount is simply taken to be an ETP.

Capital proceeds received in instalments

If a company or trust receives the capital proceeds from a CGT event in instalments and chooses the retirement exemption, it must make an ETP in relation to each of its concession stakeholders on receipt of each instalment. As mentioned earlier, the ETPs must be made by the later of seven days after the choice is made and seven days after an instalment of the capital proceeds is received.

In this situation, the total amount of each instalment must be paid as ETPs until the total of the ETPs equals the capital gain being disregarded. In other words, the requirement to make ETPs must be satisfied to the greatest extent possible out of the initial instalments rather than in some other way, such as an apportionment across all the instalments received.

Example

A company sells an active asset for $500,000 making a $110,000 capital gain. The company chooses to disregard the capital gain under the retirement exemption. The sale agreement provides that the purchaser must pay $100,000 at settlement (1 January 2003) and a further $100,000 a year for the next four years (on 1 January 2004, 1 January 2005, 1 January 2006 and 1 January 2007). The company chooses the retirement exemption when it lodges its tax return on 1 October 2003.

ETPs totalling $100,000 must be made by 8 October 2003 (that is, seven days after 1 October 2003, given the choice was made after the first instalment was received). As well, further ETPs totalling $10,000 must be made by 8 January 2004 (that is, seven days after the second instalment was received).

None of the following alternatives are permissible:

- ETPs of $22,000 each paid by 8 October 2003, 8 January2004, 8 January 2005, 8 January 2006 and 8 January 2007 respectively
- ETPs of any amount paid by 8 October 2003, 8 January 2004, 8 January2005, 8 January 2006 and 8 January 2007 respectively providing they total $110,000, or
- ETPs totalling $110,000 paid by 8 January2007.

Actual capital proceeds required

You must receive actual capital proceeds from the CGT event to be able to choose the retirement exemption. If the market value substitution rule has applied to increase the capital proceeds to the market value of the CGT asset, the retirement exemption is available only to the extent of the actual capital proceeds you receive.

Example

In 2003 Harry retires from farming and transfers the farm (which he acquired in 1993) to his son for no consideration. As Harry did not receive any capital proceeds, the market value substitution rule applies to deem the capital proceeds to equal the market value of the farm. Accordingly, Harry makes a capital gain.

No amount of the gain is eligible for the retirement exemption as Harry did not receive any capital proceeds. However, the capital gain may be eligible for the CGT discount and the 50% active asset reduction if the relevant conditions are satisfied.

CGT retirement exemption limit

The amount of the capital gain that you choose to disregard (that is, the CGT exempt amount) must not exceed your 'CGT retirement exemption limit' or, in the case of a company or trust, the CGT retirement exemption limit of each CGT concession stakeholder receiving an ETP.

An individual's lifetime CGT retirement exemption limit is $500,000, reduced by any previous CGT exempt amounts the individual has disregarded under the retirement exemption. For a company or trust with two CGT concession stakeholders, the limit is effectively $1 million ($500,000 for each stakeholder).

A company or trust may determine the percentage of the exempt amount attributable to each stakeholder, having regard to each stakeholder's retirement exemption limit (or remaining limit) and their reasonable benefit limit.

Example

Daryl and his wife Mary each own 50% of the shares in a company and are both controlling individuals of the company. The company makes a capital gain and specifies Daryl's percentage of the exempt amount to be 90% (which means that the percentage specified for Mary must be 10%). Daryl's retirement exemption limit is $500,000.

To determine whether his exemption limit is exceeded, Daryl would take 90% of the exempt amount, add that to amounts previously specified and see whether the total exceeds $500,000.

Consequences of choosing the exemption

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Consequences of choosing the exemption

Last updated 10 September 2007

If you choose this exemption, you disregard the amount of the capital gain you have chosen as the CGT exempt amount.

The amount of any capital gain that exceeds the CGT exempt amount does not qualify for this exemption.

Superannuation reasonable benefit limit consequences

Exempt amounts that are taken to be ETPs (for small business individuals) or paid as ETPs (for companies and trusts) are not subject to tax in the hands of the individual unless they exceed the recipient's reasonable benefit limit (RBL).

RBLs are the maximum amount of superannuation benefits a person can receive during their lifetime on a concessionally taxed basis. Any amounts received in excess of their RBL are taxed at the top marginal rate.

There are two types of RBL - a lump sum RBL and a pension RBL. For the year ended 30 June 2004, the lump sum RBL is $588,056 and the pension RBL is $1,176,106.

QC 27357

Small business rollover

Last updated 10 September 2007

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The rules covering the small business rollover are contained in Subdivision 152-E of the Income Tax Assessment Act 1997.

Interaction with other concessions

The small business rollover allows you to defer the capital gain made from a CGT event if you acquire one or more replacement assets and satisfy certain conditions. If the replacement asset's use changes (for example, you no longer use it in the business or you sell it), or there is a change in circumstances, the deferred capital gain will crystallise, that is, you will make a capital gain equal to the capital gain previously deferred.

You may choose to apply the small business rollover:

- after the small business 50% active asset reduction - that is, to the remaining 50% (or if the CGT discount has also applied, the remaining 25%) of the capital gain after you have applied capital losses, or
- instead of the small business 50% active asset reduction - that is, to the capital gain remaining after you have applied any capital losses and CGT discount. Making this choice might ultimately allow a company or trust to make larger tax-free ETPs under the small business retirement exemption if they choose the retirement exemption after the deferred capital gain has crystallised, for example, when the replacement asset is later sold.

You may instead choose the small business retirement exemption if its conditions are satisfied or you may choose both concessions for different parts of the remaining capital gain.

Conditions to be satisfied

You can choose to obtain a rollover if:

- you satisfy the basic conditions for the gain
- you choose one or more CGT assets as replacement assets within the period starting one year before and ending two years after the last CGT event happens in the income year for which you choose the rollover
- the replacement asset
  - is acquired within that same period (the Commissioner may extend the time limit)
  - is an active asset when you acquire it, or an active asset by the end of two years after the last CGT event happens in the income year for which you choose the rollover. A depreciating asset such as plant can be a replacement asset

- if the replacement asset is a share in a company or an interest in a trust, you, or an entity connected with you, must be a controlling individual of that company or trust just after you acquire the share or interest. As the share or interest also needs to be an active asset this means the company or trust must satisfy the 80% test. That is, the market value of the active assets and certain capital proceeds of the company or trust must be 80% or more of the total of the market value of all the assets of the company or trust.

Example

Jordan owns 50% of the shares in Company A and Company B. He is therefore a controlling individual of both companies. The companies are connected with Jordan because he controls both of them.

Company A owns land which it leases to Jordan for use in a business. It sells the land at a profit and buys shares in Company B as replacement assets. All of Company B's assets are active assets.

The replacement asset test is satisfied because the shares are active assets and Jordan is connected with Company A and is a controlling individual of Company B.

Consequences of choosing the rollover

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Consequences of choosing the rollover

Last updated 10 September 2007

If you choose the rollover, you can disregard the capital gain to the extent that it does not exceed the total of:

- the amount paid to acquire the replacement asset (that is, the first element of the cost base of the replacement asset)
- any incidental costs incurred in acquiring that asset (that is, the second element of the cost base of the replacement asset).

You make a capital gain from the CGT event equal to the amount of the capital gain that is not disregarded.

> Example
>
> The original capital gain was $100,000. It has been reduced to $25,000 under the CGT discount and 50% active asset reduction. If the total of the first and second elements of the cost base of the replacement asset is $20,000, $20,000 can be disregarded under the rollover leaving a final capital gain of $5,000.

Realisation of the capital gain rolled-over

The capital gain that is disregarded under the small business rollover will crystallise if:

- there is a change in the status of the replacement asset, or
- the replacement asset is a share in a company or an interest in a trust and there is a change in circumstances during your ownership of the asset.

Change in status of replacement asset

A CGT event (CGT event J2) happens if there is a change in the status of a replacement asset you chose for the small business rollover.

Some examples of when CGT event J2 happens include:

- the replacement asset stops being your active asset, for example, you dispose of the asset or you stop using it or holding it ready for use in your business
- the replacement asset becomes your trading stock, or
- you start to use the replacement asset solely to produce exempt income.

When CGT event J2 happens to your replacement asset, you make a capital gain equal to the gain previously disregarded under the small business rollover. This capital gain may qualify for:

- further rollover, if you acquire another replacement asset, or
- the retirement exemption.

You cannot apply the CGT discount, the 15-year exemption or the small business 50% reduction to reduce this capital gain.

If you dispose of a replacement asset another CGT event (CGT event A1) happens in addition to CGT event J2. Any capital gain you make from CGT event A1 on the disposal of the replacement asset may qualify for any of the small business CGT concessions if the relevant conditions are satisfied.

Example

Peter disposes of an active asset for $10,000, making a capital gain of $2,000. He buys two replacement assets (not being depreciating assets) for $5,000 each and chooses the small business rollover.

$1,000 of the capital gain is disregarded for each replacement asset.

Assume that one of the replacement assets is later sold for $7,500, resulting in Peter making a capital gain of $2,500.

He will also make a capital gain of $1,000 as the sale of the replacement asset results in that asset no longer being an active asset. The $1,000 capital gain represents the capital gain made on the disposal of the active asset that was rolled over in respect of this replacement asset.

Peter's capital gain of $1,000 made from the crystallising of the deferred capital gain (CGT event J2) may be eligible for further rollover relief or the retirement exemption. The capital gain of $2,500 made from the disposal of the replacement asset (CGT event A1) may be eligible for any of the concessions if the relevant conditions are satisfied.

Change in circumstances where the replacement asset is a share or trust interest

A CGT event (CGT event J3) happens if you choose a share in a company or an interest in a trust as a replacement asset under the small business rollover and:

- you, or an entity connected with you, cease to be a controlling individual of the company or trust
- if the replacement asset conditions were satisfied because an entity connected with you was a controlling individual of the company or trust, that entity stops being connected with you, or
- the share or interest ceases to be an active asset. That is, the market value of the active assets and certain capital proceeds of the company or trust fall below 80% of the total market value of all the assets of the company or trust (except where this is only because of changes in the market value of assets owned by the company or trust when you chose the replacement asset).

When CGT event J3 happens, you make a capital gain equal to the gain previously disregarded under the small business rollover. This capital gain may qualify for:

- further rollover, if you acquire another replacement asset, or
- the retirement exemption.

You cannot apply the CGT discount, the 15-year exemption or the small business 50% reduction to reduce this capital gain.

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