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Australian Taxation Office

Guide to capital gains tax concessions for small business

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.

The guide remains correct for the 2005–06 income year. An updated version of the guide for the 2006–07 and later income years is currently being prepared.

For more information visit **www.ato.gov.au**

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ABOUT THIS GUIDE

This guide provides general information about the capital gains tax (CGT) concessions available for small business.

The concessions may apply to CGT events happening after 11.45am, by legal time in the Australian Capital Territory, on 21 September 1999 (we hereafter refer to this as 11.45am on 21 September 1999).

When we refer to 'you' or 'your business' in this guide, we are referring to you as a small business entity, for example, an individual (such as a sole trader), a partner in a partnership, a company or a trust that conducts a small business.

The guide assumes you have a basic understanding of how the CGT system works. It deals with the special CGT concessions available to you as a small business, not with your personal CGT obligations. If you need more information about capital gains tax in general, see the *Guide to capital gains tax* (NAT 4151).

For a more detailed explanation of the capital gains tax concessions for small business, see the *Advanced guide to capital gains tax concessions for small business* (NAT 3359). You may also want to discuss your capital gains tax situation with your tax adviser.

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QUICK GUIDE TO CGT CONCESSIONS FOR SMALL BUSINESS

GETTING STARTED

01

OVERVIEW OF CAPITAL GAINS TAX

WHAT IS CAPITAL GAINS TAX?

Capital gains tax (CGT) is the tax you pay on any capital gain you make that you include in your annual income tax return.

There is no separate tax on capital gains – rather, it is a component of your income tax. You are taxed on your net capital gain at your marginal tax rate.

Your net capital gain is the difference between your total capital gains for the year and your total capital losses (from your business and other assets), less any relevant CGT discount or concessions. Any net capital gain you make for an income year must be included in your assessable income.

CGT EVENTS

A capital gain or capital loss is made when certain events or transactions (called CGT events) happen. Most CGT events involve a CGT asset.

Some CGT events, such as the disposal of a CGT asset, happen often and affect many different taxpayers. Other CGT events are rare and affect only a few taxpayers, for example, events concerned directly with capital receipts and not involving a CGT asset.

CGT ASSETS

The most common CGT assets are land and buildings, shares in a company or units in a unit trust.

Less well-known CGT assets include contractual rights, options, foreign currency, leases, licences and goodwill.

CAPITAL GAINS AND LOSSES

In general, you make a capital gain if you receive an amount from a CGT event (such as the disposal of a CGT asset) that is more than your total costs associated with that event.

You make a capital loss if you receive an amount from a CGT event that is less than the total costs associated with that event.

In some cases you are taken to have received the market value of the CGT asset even if you received a different amount or nothing at all. This may be the case, for example, when you give an asset away.

You can use a capital loss only to reduce a capital gain – not to reduce other income. You can generally carry forward any unused capital losses to a later income year and apply them against capital gains in that year.

Generally, you can disregard any capital gain or loss made on an asset you acquired before 20 September 1985.

DEPRECIATING ASSETS

There are special rules that 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.

You make a capital gain or capital loss from a depreciating asset only to the extent you have used the depreciating asset for a non-taxable purpose (for example, for private purposes).

MORE INFORMATION

For more general information about how capital gains tax works, see:

- *Guide to capital gains tax* (NAT 4151)
- *Guide to depreciating assets* (NAT 1996)

CGT RECORDS YOU NEED TO KEEP

You must keep records of everything that may be relevant to working out whether you have made a capital gain or capital loss from an asset.

This means you need records to substantiate the purchase and disposal of any asset, as well as other costs relating to the asset. Records can include contracts, valuations, and details of commissions and legal fees paid.

The records must:

- show the nature of the act, transaction, event or circumstance, and the date it happened
- be in English, or in a form that can be readily translated into English, and
- be kept for five years after you sell or otherwise dispose of an asset, unless you keep a CGT asset register (see below).

> **IT PAYS TO KEEP GOOD RECORDS**
>
> If you don't keep proper CGT records you may:
>
> - incur extra expense in establishing the cost of an asset when you come to dispose of it, and
> - have to pay more tax.

CGT ASSET REGISTER

You may find that a simpler way to keep records of assets is to keep a CGT asset register. This is a register of information about your CGT assets that you've transferred from your CGT records (for example, invoices, receipts and contracts).

For most assets this information includes:

- the date the asset was acquired
- the cost of the asset
- a description, amount and date for each cost associated with purchasing the asset (for example, stamp duty and legal fees)
- the date the asset was disposed of
- the amount received on disposal of the asset, and
- any other information relevant to calculating your CGT obligation.

You can discard your CGT records five years after having an asset register entry certified if:

- you enter all the necessary information about an asset in your CGT asset register
- the entry is in English and is certified in writing by an approved person (for example, a registered tax agent), and
- the asset register entry is certified after 31 December 1997 (although the asset itself may have been acquired before this date).

If you don't keep an asset register, you generally have to keep CGT records for at least five years after you dispose of an asset. For example, if you hold an asset for 10 years and then sell it, you'd have to keep the records for 15 years.

EXAMPLE: CGT asset register

> Ethan is 25 and bought a business property on 1 January 1998.
>
> His tax agent advised him to transfer the relevant CGT information from his records (for example, date he purchased the property, purchase price, stamp duty, legal expenses) to an asset register. Ethan did this and his agent certified the register on 1 July 1998.
>
> Ethan sold the property on 15 September 2003.
>
> Because Ethan had recorded the details of the property on an asset register, he had to keep records relating to the property only until 1 July 2003, rather than 15 September 2008.

> **MORE INFORMATION**
>
> - Taxation Ruling TR 2002/10 Income tax: capital gains tax: asset register

OVERVIEW OF THE CGT CONCESSIONS FOR SMALL BUSINESS

PROPOSED CHANGES

The government has announced proposed changes to some of the rules concerning the small business CGT concessions. Refer to the Treasurer's Press Release No. 38 of 2006, dated 9 May 2006, for more detail.

If you made a capital gain from a CGT event (such as the disposal of a CGT asset) that happened after 11.45am on 21 September 1999, you may be able to reduce the capital gain using:

- the CGT discount, and/or
- one or more of the four CGT concessions available for small business.

CGT DISCOUNT

You may be eligible to use the CGT discount to calculate your capital gain if:

- the CGT event giving rise to the capital gain happened after 11.45am on 21 September 1999, and
- you owned the asset involved for at least 12 months.

The CGT discount isn't limited to capital gains from business assets.

The discount allows individuals (including partners in partnerships) and trusts to reduce their capital gain by 50%. There are further rules for beneficiaries who are entitled to a share of a trust capital gain. Companies can't use the CGT discount.

WHEN TO APPLY THE CGT DISCOUNT

You apply the CGT discount after offsetting your capital losses against your capital gains, but before applying the small business CGT concessions (apart from the small business 15-year exemption).

SMALL BUSINESS CGT CONCESSIONS

The following four CGT concessions are available only for small business.

1. **The small business 15-year exemption** provides a total exemption for a capital gain on a CGT asset if you have continuously owned the asset for at least 15 years and the relevant individual is 55 or over and retiring, or is permanently incapacitated.
2. **The small business 50% active asset reduction** provides a 50% reduction of a capital gain.
3. **The small business retirement exemption** provides an exemption for capital gains up to a lifetime limit of $500,000. If the recipient is under 55, the amount must be paid into a superannuation (or similar) fund.
4. **The small business rollover** provides a deferral of a capital gain if a replacement asset is acquired. However, you may make a capital gain equal to the deferred gain if the replacement asset is disposed of or its use changes in particular ways. In this case, the deferred capital gain is in addition to any capital gain made when the replacement asset is disposed of.

How the CGT concessions work

To be eligible for any of the concessions, you must first satisfy several basic conditions, which are outlined on pages 12–14.

NOTE:

- more than one of the four concessions may apply to the same capital gain if the conditions for each are satisfied
- they may apply in addition to the CGT discount if it also applies
- if the small business 15-year exemption applies, you can disregard the entire capital gain and therefore don't need to apply any further concessions
- with the exception of the small business 15-year exemption, you apply the small business concessions after reducing any capital gains by all available capital losses
- if you have more than one capital gain, you can choose the order in which to reduce capital gains by capital losses, and
- the small business CGT concessions don't apply to gains from depreciating assets.

APPLYING THE CGT CONCESSIONS TO A CAPITAL GAIN FROM A SMALL BUSINESS ASSET

02

The flow chart on the next page shows the order in which you apply capital losses and the CGT concessions to *each* capital gain made after 11.45am on 21 September 1999.

> ! You don't necessarily have to go through each step. For example, if you qualify for the small business 15-year exemption, you can disregard the entire capital gain and therefore don't need to complete the remaining steps.
>
> Also, you can choose not to apply the 50% active asset reduction and go straight to the small business retirement exemption or rollover.

Throughout this guide we use the example of Lana, a sole trader, to illustrate how losses and the CGT concessions can be applied to a capital gain made by a small business.

EXAMPLE: Lana – a sole trader

Lana operates a small manufacturing business as a sole trader. The net value of her CGT assets and those of related entities doesn't exceed $5 million.

Her husband Max carries on his own florist business, which is unrelated to Lana's manufacturing business.

Max owns the land and building from which Lana's manufacturing business is conducted (apart from a small parcel of nearby land owned by Lana that is also used in her business) and leases it to Lana.

Lana has owned the small parcel of land for three years and used it in her business for the last two years. She decides to sell the land and makes a capital gain of $17,000 when she disposes of it.

In the same year as Lana makes the $17,000 capital gain on the sale of the land, she also makes a capital loss of $3,000 from the sale of another asset.

CAPITAL GAINS MADE DURING AN INCOME YEAR

You make a capital gain from a depreciating asset only to the extent 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.

NO → You don't qualify for any of the small business CGT concessions. You may be eligible for the CGT discount. → Step 3

YES ↓

Step 2: Determine whether you qualify for the small business 15-year exemption (not relevant to capital gains from depreciating assets).

NO → Step 3

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. If so, reduce the remaining capital gain.

↓

Step 5: Determine whether the capital gain is from a depreciating asset 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.

↓

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

STEP 1

DETERMINE WHETHER YOU SATISFY THE BASIC CONDITIONS FOR THE SMALL BUSINESS CGT CONCESSIONS

To qualify for any of the small business CGT concessions, you must first satisfy several basic conditions. These conditions are in the form of three tests, namely:

(a) the **maximum net asset value test**

(b) the **active asset test**, and

(c) the **controlling individual test**. This test applies only where the CGT asset is a share in a company or interest in a trust, and the individual claiming the concession is a CGT concession stakeholder in the company or trust.

(a) THE MAXIMUM NET ASSET VALUE TEST

To pass this test, you and your related entities (see the next page) must not own assets with a total net value of more than $5 million just before the CGT event that results in the capital gain.

The net value of the CGT assets of an entity is the total market value of its assets, less any liabilities relating to those assets. The $5 million limit isn't indexed for inflation.

If you are a partner in a partnership and the CGT event happens in relation to a CGT asset of the partnership (for example, disposal of a partnership asset), the net value of the CGT assets of the partnership also can't be more than $5 million.

This isn't the case if only one of the partners in a partnership is disposing of an interest in a partnership asset (that is, other partners are retaining 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.

What assets are *not* included?

Do *not* include the following assets when calculating the net value of your CGT assets:

- shares, units or other interests (apart from debt) held in any entities connected with you or your small business CGT affiliates (because the net value of the CGT assets of connected entities has already been included)
- any assets of a small business CGT affiliate or an entity connected with a small business CGT affiliate that are not used, or held ready for use, in a business carried on by you or by an entity connected with you (unless the entity is connected with you only through your small business CGT affiliate)
- if you are an individual, assets that are solely for your personal use (or the personal use of your CGT affiliates) or superannuation assets, and
- if you are an individual, your own home, provided that you wouldn't be entitled to a tax deduction for interest if you had taken out a loan to purchase it. If you are entitled to a deduction, the total market value of your home is included in the maximum net asset value test, even if you use it mainly for private purposes.

EXAMPLE: Calculating the net value of assets

The market value of Lana's CGT assets is:

Land used in business	$50,000
Business goodwill	$200,000
Trading stock	$100,000
Plant	$50,000
Boat (used solely for personal use)	$50,000
Home (used solely for personal use)	$300,000
	$750,000

Lana borrowed $20,000 to buy the boat.

Lana doesn't include the market value of her home and boat, or the liability relating to the boat, when calculating the net value of her CGT assets.

The net value of her CGT assets is therefore:

$750,000 – $350,000 = $400,000.

If Lana used her home partially for income producing purposes and would have been entitled to a deduction for interest if she had borrowed money to purchase it, she would include the market value of the home in the net value of her CGT assets. If there was a $100,000 mortgage on the home, the net value of Lana's CGT assets would be:

$700,000 – $100,000 = $600,000.

DEPRECIATING ASSETS

Even though gains from depreciating assets may be treated as income (rather than a capital gain), depreciating assets are CGT assets and taken into account for the maximum net asset value test.

What are related entities?

Related entities include:

- any of your small business CGT affiliates
- any entities connected with you, and
- any entities connected with a small business CGT affiliate.

A small business CGT affiliate includes your spouse or child under 18 years, or any person (including a company) that acts or could reasonably be expected to act:

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

An entity is 'connected with' another entity if:

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

EXAMPLE: The maximum net asset value test

For the maximum net asset value test, Lana includes the market value of the land and building owned by her husband Max ($500,000), less any related liability ($400,000 mortgage). She does this because the land and building are used in her manufacturing business.

But she doesn't include Max's other assets used in his florist business because they aren't used in her manufacturing business.

Accordingly, the net value of the CGT assets of Lana's small business CGT affiliate (that is, her husband Max) to be included is:

$500,000 – $400,000 = $100,000.

There are no entities connected with Lana.

As the net value of Lana's CGT assets and those of related entities doesn't exceed $5 million, she satisfies the maximum net asset value test.

MORE INFORMATION

See *Advanced guide to capital gains tax concessions for small business* (NAT 3359) for more information about the meaning of control in relation to partnerships, companies and trusts, and about the maximum net asset value test.

(b) THE ACTIVE ASSET TEST

This test requires the CGT asset to be an 'active asset' at a particular time and for half a particular period.

Broadly, if you have not ceased your business 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 the asset has been owned for more than 15 years, it needs to be an active asset for at least half of the 15-year period ending at the time of the CGT event (or when your business ceased, if earlier).

There are modified rules for CGT assets acquired or transferred under the rollover provisions relating to assets compulsorily acquired, lost or destroyed, or those relating to marriage breakdown.

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

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

In some circumstances, a share in a company or an interest in a trust can also be an active asset. However, certain CGT assets can't be active assets, even if they are used or held ready for use in the course of carrying on a business. Examples of assets that can't be active assets include financial instruments such as loans, bonds, share options and assets whose main use is to derive rent.

EXAMPLE: The active asset test

Lana has used the land in her business for at least half the period she owned it, that is, for two out of the three years she owned it. Further, she was using the land in her business just before she sold it.

Lana therefore satisfies the active asset test.

MORE INFORMATION

- *Advanced guide to capital gains tax concessions for small business* (NAT 3359)

(c) THE CONTROLLING INDIVIDUAL/CGT CONCESSION STAKEHOLDER TEST

The controlling individual test is different from 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.

This test is a basic condition only if the asset from which the capital gain was made is a share in a company or an interest in a trust. (However, some of the concessions have further controlling individual requirements.)

A company or trust satisfies the controlling individual test if it had at least one controlling individual just before the CGT event.

An individual is a controlling individual of a company if the individual holds 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.

If a company has no individual shareholders it will not have a controlling individual.

EXAMPLE: A controlling individual

Lana's uncle Joe conducts his own business (through Company X) entirely separate to Lana's business. Joe owns shares carrying 60% of the voting and distribution rights in Company X and is thus a controlling individual of the company.

If Joe owned 50% and his wife Anne owned 50%, they would both be controlling individuals of the company.

On the other hand, 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.

There are also rules about when an individual is a controlling individual of a fixed trust (for example, unit trust) or a discretionary trust.

A CGT concession stakeholder of a company or trust means:

- a controlling individual of the company or trust, or
- in some cases, a spouse of a controlling individual.

A company or trust will have two, one or no CGT concession stakeholders. It will not have a CGT concession stakeholder if it doesn't have a controlling individual. For example, if three brothers have equal interests in a company or trust, there will be no CGT concession stakeholders because there are no controlling individuals.

EXAMPLE: The controlling individual/CGT concession stakeholder test

As the land Lana sold wasn't a share in a company or interest in a trust, the third basic condition, the controlling individual/CGT concession stakeholder test, doesn't apply to her.

Accordingly, Lana satisfies the basic conditions for the small business CGT concessions.

Most of the concessions have further specific conditions, which Lana must now consider.

MORE INFORMATION

See *Advanced guide to capital gains tax concessions for small business* (NAT 3359) for more information about the rules for fixed and discretionary trusts, and about the controlling individual/CGT concession stakeholder test.

STEP 2

DETERMINE WHETHER YOU QUALIFY FOR THE SMALL BUSINESS 15-YEAR EXEMPTION

If you qualify for the small business 15-year exemption, you can disregard the capital gain entirely and don't need to apply any further concessions. There's no need to apply capital losses before you apply the 15-year exemption.

> **GAINS FROM DEPRECIATING ASSETS**
>
> If the capital gain is from a depreciating asset, you can't use the 15-year exemption.

Do you qualify?

You qualify for the small business 15-year exemption if:

- you satisfy the basic conditions for the small business CGT concessions (the asset must have been an active asset for at least half of the relevant 15-year period, not half of the full period of ownership)
- you continuously owned the CGT asset for the 15-year period ending just before the CGT event, and
  - where you are an individual in business, at the time of the CGT event you were 55 years or more and the event was connected with your retirement, or you were permanently incapacitated
  - where you are an individual in business and the CGT asset is a share in a company or an interest in a trust, the company or trust had a controlling individual for the entire time you owned the share or interest (not necessarily the same individual for the whole period), or
  - where you are a company or trust, the company or trust had a controlling individual for the entire time it owned the CGT asset (not necessarily the same individual for the whole period). Further, at the time of the CGT event the controlling individual must have been 55 years or more and the event must have been connected with their retirement, or they must have been permanently incapacitated.

For CGT assets acquired or transferred under the rollover provisions relating to assets compulsorily acquired, lost or destroyed, or those relating to marriage breakdown, there are modified rules about the requirement that the asset be continuously owned for at least 15 years.

EXAMPLE: Small business 15-year exemption

Lana doesn't qualify for the small business 15-year exemption as she has owned the land for only three years. However, she does have a capital loss and may qualify for the CGT discount and one or more of the other small business CGT concessions.

On the other hand, Lana's friends Ruth and Geoff do qualify for the exemption. They 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 decide to retire as they are both over 60 years of age. They sell the land (the major asset of the farming business) in 2003 for a total capital gain of $100,000.

As Ruth and Geoff qualify for the small business 15-year exemption in relation to the capital gain, they can disregard the entire gain. They don't need to apply any other concessions.

> **LOSSES**
>
> If you make a capital loss from the CGT event, you can use the loss to reduce other capital gains.

> **MORE INFORMATION**
>
> - *Advanced guide to capital gains tax concessions for small business* (NAT 3359)

STEP 3

OFFSET ANY CAPITAL LOSSES

If you have any capital losses for the current year or losses carried forward from a previous year, you must use them to reduce the capital gain before applying any of the remaining concessions.

EXAMPLE: Capital losses

In the same year as Lana made the $17,000 capital gain on the sale of land, she also made a capital loss of $3,000 from the sale of another asset.

She must offset the loss against the gain before applying any of the remaining concessions, as follows:

$17,000 – $3,000 = $14,000

Lana may be able to reduce her capital gain further using the CGT discount and one or more of the other small business CGT concessions.

STEP 4

DETERMINE WHETHER YOU ARE ELIGIBLE FOR THE CGT DISCOUNT

The CGT discount allows individuals (including partners in partnerships) and trusts to reduce their capital gain by 50%. There are further rules for beneficiaries who are entitled to a share of a trust capital gain. Companies can't use the CGT discount.

Note that the discount isn't limited to small business capital gains, but can also be applied to personal capital gains.

CAPITAL GAINS AND DEPRECIATING ASSETS

You make a capital gain from a depreciating asset only to the extent you have used the depreciating asset for a non-taxable purpose (for example, for private purposes). Such a gain may be eligible for the CGT discount.

Are you eligible?

To be eligible for the CGT discount:

- the CGT event giving rise to the capital gain must have happened after 11.45am on 21 September 1999, and
- you must have owned the asset involved for at least 12 months.

Certain CGT events, such as where new assets are created, don't qualify for the CGT discount because the 12-month rule wouldn't be satisfied.

If you are eligible for the CGT discount, reduce the capital gain by 50%.

EXAMPLE: CGT discount

After offsetting her $3,000 capital losses against her $17,000 capital gain, Lana is left with a capital gain of $14,000. As she is eligible for the CGT discount, she can reduce the remaining capital gain by 50%, as follows:

$14,000 – (50% *x* $14,000) = $7,000

Lana may be able to reduce her capital gain further using one or more of the other small business CGT concessions.

MORE INFORMATION

- *Guide to capital gains tax* (NAT 4151)
- *Capital gains tax: CGT discount – questions and answers* (NAT 5456)

STEP 5

DETERMINE WHETHER THE CAPITAL GAIN IS FROM A DEPRECIATING ASSET

You can make a capital gain or capital loss from the disposal of a depreciating asset only to the extent that you use the depreciating asset for a non-taxable purpose (for example, for private purposes).

If the capital gain is from a depreciating asset, you can't use any of the small business CGT concessions to reduce the gain any further.

If it isn't from a depreciating asset, you may be able to reduce your capital gain further under the remaining small business CGT concessions.

EXAMPLE: Depreciating assets

The land that Lana disposed of was not a depreciating asset so she can use the remaining small business CGT concessions to reduce her capital gain if she satisfies the relevant conditions.

MORE INFORMATION

- *Guide to depreciating assets* (NAT 1996)

STEP 6

DETERMINE WHETHER YOU QUALIFY FOR THE SMALL BUSINESS 50% ACTIVE ASSET REDUCTION

You can choose not to apply the 50% active asset reduction and go straight to the small business retirement exemption or rollover (see the next page).

Do you qualify?

To qualify for the small business 50% active asset reduction on a capital gain, you need to satisfy only the basic conditions (see pages 12–14).

This means that if you satisfy the basic conditions you can reduce the capital gain by 50% (after applying any current year capital losses and any unapplied net capital losses from a previous year).

If you are an individual or trust and both the CGT discount and the small business 50% active asset reduction apply, you reduce the capital gain by 50%, then 50% of the remainder – that is, a total of 75%.

EXAMPLE: Small business 50% active asset reduction

Lana qualifies for the small business 50% reduction because the basic conditions are satisfied. She can therefore reduce her capital gain by a further 50%, as follows:

$7,000 – (50% *x* $7,000) = $3,500

Lana may be able to reduce her capital gain further using the small business retirement exemption or the small business rollover.

MORE INFORMATION

- *Advanced guide to capital gains tax concessions for small business* (NAT 3359)

STEP 7

DETERMINE WHETHER YOU QUALIFY FOR THE SMALL BUSINESS RETIREMENT EXEMPTION OR ROLLOVER

You may choose the small business retirement exemption or the small business rollover for the remaining amount of capital gain if you satisfy the conditions. Alternatively, you may choose both concessions for different parts of the remaining capital gain.

SMALL BUSINESS RETIREMENT EXEMPTION

This concession interacts with the eligible termination payment 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 eligible termination payment provisions if the recipient is under 55.

If you apply the small business retirement exemption after the small business 50% active asset reduction, you apply the exemption to the remaining 50% of the gain. If the CGT discount has also applied, you apply the exemption to the remaining 25% of the capital gain.

If you choose this concession, you can disregard only the amount of capital gain equal to your exempt amount (that is, the amount chosen to be disregarded). You can't disregard any capital gain that exceeds the exempt amount.

Do you qualify?

Individuals in business

If you are an individual in business, you can use the small business retirement exemption to disregard all or part of a capital gain remaining after other concessions have applied if:

- you satisfy the basic conditions (see pages 12–14)
- you keep a written record of the amount you have chosen to disregard (the exempt amount), and
- where you were under 55 years just before you received the capital proceeds from the CGT event, you roll over an amount equal to the exempt amount under the eligible termination payment provisions. (If you were 55 or more there's no requirement to roll over any amount.)

The exempt amount you choose to disregard under this concession is taken to be an eligible termination payment paid to you. It must not exceed your CGT retirement exemption limit.

Companies and trusts

If you are a company or trust (other than a public entity), you can also use the small business retirement exemption to disregard all or part of a capital gain remaining after other concessions have applied if you:

- satisfy the basic conditions (see pages 12–14)
- satisfy the controlling individual test
- keep a written record of the amount you have chosen to disregard (the exempt amount) and, where there are two CGT concession stakeholders, of each stakeholder's percentage of the exempt amount (one may be nil, but both must add up to 100%)
- make an eligible termination payment for each of your CGT concession stakeholders based on each individual's percentage of the exempt amount. The payment must be made by the end of seven days after the company or trust chooses to disregard the capital gain or receives an amount of capital proceeds from the CGT event, whichever occurs later, and
- where a stakeholder is under 55 years just before receiving the eligible termination payment, roll over an amount equal to that payment under the eligible termination payment provisions.

The exempt amount mustn't exceed the CGT retirement exemption limit of each individual receiving an eligible termination payment.

Choosing the retirement exemption for a capital gain (subject to the $500,000 limit) without first applying the 50% active asset reduction might allow a company or trust to make larger tax-free eligible termination payments.

EXAMPLE: Small business retirement exemption

After offsetting her capital losses and applying the CGT discount and the small business 50% active asset reduction, Lana has a capital gain of $3,500.

Lana could choose the small business retirement exemption but, as she is under 55 years of age, she would need to pay the amount into a superannuation (or similar) fund.

Lana decides she needs the funds to reinvest in the business and so doesn't choose the retirement exemption.

MORE INFORMATION

- *Advanced guide to capital gains tax concessions for small business* (NAT 3359)

SMALL BUSINESS ROLLOVER

The small business rollover allows you to defer making a capital gain from a CGT event that happens in relation to a small business asset if you acquire a replacement asset and meet certain conditions.

If the way a replacement asset is used changes or there is a change in circumstances, the deferred capital gain will 'crystallise'. This means that you will make a capital gain equal to the deferred gain. You may defer this crystallised capital gain by choosing a further small business rollover. However, you can't apply the CGT discount or the small business 50% active asset reduction.

If you apply the small business rollover after the small business 50% active asset reduction, you apply it to the remaining 50% of the gain. If the CGT discount has also applied, you apply the rollover to the remaining 25% of the capital gain.

Do you qualify?

Your business qualifies to roll over a capital gain if:

- you satisfy the basic conditions (see pages 12–14)
- 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 you are choosing the rollover for
- you acquire the replacement asset within that same period (the Commissioner may extend the time limit)
- the replacement asset is an active asset when it is acquired or an active asset by the end of two years after the last CGT event happens in the income year you are choosing the rollover for, and
- 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.

If you meet these conditions and choose the rollover, you can reduce the amount of any remaining gain by up to the cost of the replacement asset (including any incidental costs).

EXAMPLE: Small business rollover

Instead of choosing the retirement exemption, Lana acquires a replacement active asset (another small parcel of land immediately adjoining the main business premises) for use in her business. As all the necessary conditions are met, she qualifies for the small business rollover.

The replacement land costs $10,000, so she can reduce her remaining capital gain by up to that amount. This means she can reduce her capital gain remaining after all other concessions have applied ($3,500) to nil.

DEFERRED CAPITAL GAIN

The $3,500 remaining capital gain disregarded under the small business rollover is only a deferral of the capital gain. This deferred capital gain may later become assessable if Lana sells the land or stops using it in her business. However, she could then choose a further small business rollover if she acquired another replacement active asset. Alternatively, Lana could choose the retirement exemption.

MORE INFORMATION

See *Advanced guide to capital gains tax concessions for small business* (NAT 3359) for more information about circumstances involving the disposal or changed use of a replacement asset, or a change in circumstances relating to a company or trust.

DEFINITIONS

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, a small business CGT affiliate, or an entity connected with you, in the course of carrying on a business, or
- an intangible asset inherently connected with a business you carry on, for example, goodwill.

Active asset test
This test requires the CGT asset to be an active asset at a particular time and for half a particular period. It is one of the tests you must pass to satisfy the basic conditions for the small business CGT concessions.

Assessable income
This is all the income you have received that should be included in your income tax return. Generally, it doesn't include non-assessable payments from a unit trust, including a managed fund.

Capital gain
You may make a capital gain (or profit) as a result of a CGT event, for example, when you sell an asset for more than you paid for it. You can also make a capital gain if a managed fund or other unit trust distributes a capital gain to you.

Capital gains tax
Capital gains tax (CGT) is the tax you pay on any capital gain you make and include in your annual income tax return. For example, when you sell (or otherwise dispose of) an asset, you may be subject to CGT.

Capital loss
Generally, you make a capital loss as a result of a CGT event if you sell an asset for less than you paid for it (including incidental costs).

Capital proceeds
Capital proceeds is the term used to describe the amount of money or the value of any property you receive or are entitled to receive as a result of a CGT event. For shares or units, capital proceeds may be:
- the amount you receive from the purchaser
- the amount you receive from a liquidator
- the amount you receive on a merger/takeover, or
- their market value if you give them away.

CGT asset
CGT assets include shares, units in a unit trust, collectables (such as jewellery), assets for personal use (such as furniture or a boat) and other assets (such as an investment property).

CGT asset register
This is a register of information about your CGT assets that you've transferred from your CGT records (for example, invoices, receipts and contracts).

CGT concession stakeholder
A CGT concession stakeholder of a company or trust means:
- a controlling individual of the company or trust, or
- a spouse of a controlling individual where:
  - for a company, the spouse holds legal and equitable interests in any amount of shares in the company
  - for a fixed trust, the spouse is beneficially entitled to any of the income or capital of the fixed trust, or
  - for a discretionary trust, during the income year the discretionary trust made a distribution of income or capital to which the spouse was beneficially entitled.

CGT discount
The CGT discount allows eligible individuals (including partners in partnerships) and trusts to reduce their capital gain by 50%. There are further rules for beneficiaries who are entitled to a share of a trust capital gain. Companies can't use the CGT discount.

CGT event
A CGT event happens when a transaction takes place, such as the sale or purchase of a CGT asset. The result is usually a capital gain or capital loss.

Controlling individual
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.

Depreciating asset
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. Depreciating assets include computers, electric tools, furniture and motor vehicles.

Maximum net asset value test
To pass this test, you and your related entities mustn't own assets with a total net value of more than $5 million just before the CGT event that results in the capital gain. It is one of the tests you must pass to satisfy the basic conditions for the small business CGT concessions.

NAT number
Most of our publications have a NAT number (our catalogue number), which we generally show in brackets after the title of the publication, for example, *Tax basics for small business* (NAT 1908).

Net capital gain
The net capital gain is the difference between your total capital gains for the year and your total capital losses (including net capital losses from prior years), less any CGT discount or other concessions you are entitled to.

Net value
The net value of the CGT assets of an entity is the total market value of its assets, less any liabilities relating to those assets.

Related entity
Related entities include:
- any of your small business CGT affiliates
- any entities connected with you, and
- any entities connected with a small business CGT affiliate.

Small business CGT affiliate
A small business CGT affiliate includes your spouse or child under 18 years, or any person who acts or could reasonably be expected to act:
- in accordance with your directions or wishes, or
- in concert with you.

Small business entity
A small business entity can be a sole trader, partnership, company or trust.

Small business 15-year exemption
This is one of the CGT concessions available to small business. Generally, it allows you to disregard the capital gain made on an asset you have owned for 15 years if you satisfy all the conditions.

Small business 50% reduction
This is one of the CGT concessions available to small business. Generally, it allows you to reduce your capital gain by 50% if you satisfy the basic conditions.

Small business retirement exemption
This is one of the CGT concessions available to small business. Generally, it provides an exemption of capital gains up to a lifetime limit of $500,000 if you satisfy all the conditions. If you are under 55, the amount must be paid into a superannuation (or similar) fund.

Small business rollover
This is one of the CGT concessions available to small business. Generally, it allows you to defer making a capital gain from a CGT event that happens in relation to a small business asset if you acquire a replacement asset and meet certain conditions.

MORE INFORMATION

INTERNET

Visit:

- **www.ato.gov.au** to download publications, rulings and other general tax information for small businesses
- **www.ato.gov.au/onlineservices** to find out about our range of online services, including the Business Portal
- **business.gov.au** for easy access to a range of business information, services and transactions with government. There are links to Tax Office applications to register for an ABN and GST, or to apply for a tax file number.

PHONE

Phone:

- **13 28 66** (general **business** enquiries) for information about most small business tax matters, including GST, ABN, pay as you go (PAYG) instalments, amounts withheld from wages, business deductions, lodging and paying activity statements, activity statement accounts, wine equalisation tax, luxury car tax, fringe benefits tax and matters for non-profit organisations
- **13 10 20** (**superannuation** enquiries) for information about the superannuation guarantee, choice of superannuation fund and the Super Co-contribution
- **13 28 61** (**personal tax** enquiries) for information about individual income tax and general personal tax enquiries
- **1300 720 092** to order Tax Office publications (see page 2).

FAX

- Phone **13 28 60** to have information faxed to you about a range of tax-related topics.

FREE SEMINARS

- We run small business seminars on a range of topics, including GST, PAYG, activity statements and record keeping. Visit **www.ato.gov.au** or phone **1300 661 104** to find out whether there is a seminar near you or to make a booking.

OTHER SERVICES

- If you do not speak English well and want to talk to a tax officer, phone the Translating and Interpreting Service on **13 14 50** for help with your call.
- If you have a hearing or speech impairment and have access to appropriate TTY or modem equipment, phone **13 36 77**. If you do not have access to TTY or modem equipment, phone the Speech to Speech Relay Service on **1300 555 727**.

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