

Small business CGT concessions explained

Capital gains tax (CGT) considerations for small businesses can emerge in regard to all manner of otherwise unremarkable events, including but not limited to the “CGT triggers” list over the page. Business owners should keep CGT in the back of their mind when considering a range of transactions — there are activities and transactions that may not obviously, but in fact do, attract tax (which is another good reason to keep an accountant or tax professional in the loop).

The tax provisions in regard to CGT contain concessions for small businesses that recognise the fact that many small business operators commit private capital to their ventures, and frequently have little else to put away outside of their enterprise. These tax concessions therefore, by limiting the tax liability attached to capital gains, help to enable business owners either expand or otherwise change their operations, or fund retirement.

There are four CGT-related tax concessions that can be used by a business that qualifies as a “small business entity” — which means either having no more than \$2 million annual aggregated turnover, or coming under a \$6 million net asset value threshold (which may include the assets of connected entities and affiliates).

The four small business CGT concessions are:

- The 15-year exemption: Where a taxpayer who is at least 55 years of age and is retiring disposes of a CGT asset that has been owned for a minimum of 15 years
- The retirement exemption: Where capital proceeds are put towards retirement savings. A taxpayer may apply capital proceeds from

the disposal of a CGT asset to the retirement exemption, up to a lifetime maximum of \$500,000 – as it is not necessary to actually retire, the concession can be utilised more than once

- The 50% active asset reduction: The capital gain arising from the disposal of a CGT asset may be discounted by 50%
- The CGT rollover: A capital gain arising from the disposal of a CGT asset may be deferred provided a replacement asset is acquired within a period up to two years after the CGT event – the gain is deferred until disposal of the replacement asset.

Being able to access these valuable concessions can drastically reduce the amount of income tax (sometimes even down to nil, for example the 15-year exemption) that a small business has to pay on capital gains in a given year. Check with this office if you think your business may qualify.

Under the small business CGT concessions, capital gains made on the sale of active business assets for

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About this newsletter

Welcome to CCB Accountants’ client information newsletter, your monthly tax and super update, keeping you on top of the issues, news and changes you need to know. Should you require further information on any of the topics raised please contact us.

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eligible concerns are either exempt from tax, qualify for “discounts” (a proportion of the gain is tax-free, such as the 50% reduction concession), or gain “rollover relief” which defers the tax liability on the capital gain to a future year (the last is available where a replacement asset is bought within two years of the disposal of the original asset).

The asset must be used in the business, or held ready for use, to be regarded as “active” (or could be used in a business conducted by a connected entity or affiliate of the taxpayer). Land and buildings are obvious examples, but if an asset is intangible, such as goodwill, it needs to be inherently connected with the carrying on of the business. Passively held shares in a closely held company can be active assets, however there is a further test to be satisfied.

Strict eligibility conditions are in place for each of the concessions, however the value of accessing these concessions is obvious – the 15-year exemption alone can reduce your tax bill relating to the sale of that asset to zero.

In certain circumstances, for example where the small business concessions are sought by a company or a trust, a “significant individual” may need to be identified. Also known as a “CGT concession stakeholder”, this natural person will be required for a company or trust to access the retirement or 15-year exemptions, or where the assets involved are equities or interest in a trust. Ask this office about who will qualify to be a significant individual in order to gain access to the small business CGT concessions, should this seem to match your situation.

The owner of a business that overshoots the \$6 million net asset value limit should remember that the value of superannuation entitlements does not count towards the asset test threshold, however transferring assets away from a business and into super will need to be completed according to the super rules — with attention given to the contribution caps that apply.

Of course the Tax Office will be on the lookout for arrangements that are entered into merely to chase a tax advantage. In such cases, the Tax Office may be able to remove the tax concession or exemption. With CGT, records are crucial (true of anything to do with tax), so an informed approach taken with a longer term view will take the headache out of CGT considerations. Keep a record of every act, transaction or event that may be relevant, consider using an asset register, and of course consult with this office for further advice and information. ■

CGT triggers

CGT can be triggered by:

- selling an item (assets like a building or property)
- selling part of the business
- buying out a partner
- changing from a partnership to a company, and
- being paid compensation for destroyed assets.

SMSF or SAF: Which super fund option suits you?



Anecdotal evidence in the aftermath of the Trio/Astarra scam, where hundreds of Australians were devastated by the loss of their retirement savings when they deposited them into Trio Capital, suggests more

self-managed superannuation fund (SMSF) trustees may be considering converting into small APRA funds (SAFs). This may be for a number of reasons including more security, less responsibility, greater legal recourse and so forth.

An SMSF and an SAF are highly similar except for two pivotal facts – SMSFs are regulated by the Tax Office and SAFs are regulated by the Australian Prudential Regulation Authority (APRA), and SAFs are required to appoint a professional licensed trustee, which holds the ultimate responsibility for all legislative, compliance and administrative decisions made. Both contain their fair share of advantages and disadvantages, some of which we explore below:

Benefits of the SMSF structure

1. Regulatory

The regulatory regime is common to SMSFs and SAFs, however the administrative burden upon an SMSF may be considered less onerous than for an SAF.

2. Investments

SMSFs are typically more flexible than an SAF, particularly when it comes to the investments that can be owned. The options for SMSF investments are wide and varied – subject to the SIS Act, the fund's trust deed and the fund's investment strategy – but may include direct property, business real property purchased from a related party, shares and unlisted managed funds. SMSF trustees have the ultimate freedom in determining how their retirement savings should be invested. They make the decisions and they choose the fund's investment strategy as well as its direction. While the options for investment for SAFs are also quite open-ended, a professional trustee is likely to have more stringent investment restrictions than SMSFs when it comes to the approval of assets held.

3. Costs

SAF members have to pay an independent trustee to run their fund, which adds to running costs and they have higher regulatory supervisory levies of \$500, compared to \$200 for SMSFs which recently increased from \$180, amongst other administrative changes.

4. Tax reporting obligations

SAFs must meet their tax reporting obligations by October 31 whereas SMSFs can file their annual tax returns later by enlisting the services of a tax agent.

Benefits of the SAF structure

1. Compliance risk

An advantage of running an SAF is that the compliance risk is borne by the professional licensed trustee whose core responsibility is the provision of trustee services. If an SAF is in breach of the rules, the members of the fund will not be liable for the compliance mistakes of the professional trustee. In an SMSF, all members must be a trustee or director of a corporate trustee which means all members bear the compliance liability.

2. Administration

The professional licensed trustee in charge of an SAF typically appoints professional organisations to carry out the administration of the fund or is skilled and experienced enough to avoid common breaches of legislative requirements. As the professional licensed trustee administers all information and transactions,

record keeping is typically timely and accurate. In SMSFs, the trustees are typically responsible for the administration of their fund – although they can enlist the services of an adviser.

3. Protection

In the case of fraudulent conduct or theft, SAFs have more readily available redress options including a grant of financial assistance as statutory compensation and access to the Superannuation Complaints Tribunal which deals with complaints about the decisions and conduct of APRA-regulated fund trustees and other decision makers. Conversely, no compensation scheme exists for SMSFs and they instead have to rely on courts to resolve disputes or look to the Corporations Law to take action against a financial adviser for losses they believe are due to misconduct or inappropriate action.

4. Travel

SAFs are more flexible when their members go overseas for an indefinite period compared to SMSFs which are strictly regulated in that circumstance. Trustees in an SMSF who relocate for an extended period of time have to fulfil two requirements – the central management and control of an SMSF needs to be in Australia, and the active member test needs to be fulfilled (see *SMSFs: How to travel and keep your fund compliant* in our June newsletter for more information on that). If any of these requirements are breached, the SMSF loses its residency status, is deemed non-compliant and will face exorbitant penalty taxes of up to 46.5%. An SAF however can have offshore members – as long as they are Australian residents for tax purposes.

5. Disqualified persons

Investors are not allowed to be trustees of an SMSF if they have committed a crime involving dishonesty such as fraud, theft or embezzlement or if they have been declared bankrupt. The Tax Office will ban investors from taking on positions of responsibility in the superannuation arena if it believes the person has breached the superannuation laws either very seriously or persistently or it believes the person is not a fit or proper person and hence should be disqualified. There are no issues with a disqualified person becoming a member of an SAF as they are not required to fill the role of trustee.

6. Family members

In an SMSF, a trustee cannot be an employee of another member – unless they are family. In an SAF however, a member can be an employee of another member. Further, since SAFs have a professional licensed trustee, the related-party issues that crop up in an SMSF are not an issue in an SAF.

7. Responsibility

Older investors may prefer to use an SAF because they have reached an age where they are no longer able, or may not want to, make effective management and operational decisions. SAFs still allow investors to be in charge of the asset allocation – subject to trustee approval – and to acquire a similarly broad range of assets and strategies available to SMSF investors. Problems often arise in an SMSF when an older trustee loses the capacity to function and participate in the fund’s inner workings whereas in an SAF, the professional licensed trustee will continue to manage the fund for the benefit of its members.

The table below summarises the pros and cons of each setup.

It appears that an SMSF is ideal for people who want to be fully in control of their investment decisions and retirement savings while an SAF is perfect for those who would like to actively participate in investment decisions but retain a low level of compliance and

legislative responsibilities. It is possible to switch from an SMSF to an SAF or vice versa and it is important to note that trustees who switch from an SMSF to an SAF do not incur capital gains tax as they have to retire as trustees themselves and appoint a professional licensed trustee to govern their SAF. Consult this office for more information if you wish to switch fund structures. ■

**CLARIFICATION:
SMSF annual return deadline**

SMSF annual tax returns that are “self-prepared” by the fund trustee have a lodgement deadline of October 31, however anyone using the services of a registered tax agent, such as clients of this office, has an extended deadline – up to May 15 next year (generally, if there are no outstanding returns).

Self-managed super fund (SMSF)	Small APRA fund (SAF)
Your role	
You and up to three other members are trustees of your SMSF and have overall responsibility for legislative, compliance and administrative decisions of the fund.	You and up to three others are members of your SAF. A professional trustee has overall responsibility for the legislative, compliance and administrative decisions of the fund.
Key benefits	
Flexibility to create your own investment strategy, direction and ultimate freedom in determining how retirement savings are used.	Peace of mind, especially if you’re older, as the professional trustee oversees all aspects of your SAF to ensure it remains compliant.
Less tightly governed than SAFs with a less onerous compliance regime.	Less compliance risk as the liability is borne by the professional trustee.
Reasonable running costs.	Allows an otherwise disqualified person to be a member of an SAF.
SMSFs can file their annual tax returns later than SAFs, as long as they enlist the help of a tax agent.	More flexible if trustees decide to travel indefinitely.
Suitable if you....	
Want to have full control of your super investments	Want a high level of control over your investment decisions.
Have the time, resources and ability to manage your fund’s legislative, compliance and administrative decisions.	Want to manage your own super without the added responsibility of being a liable trustee.
Are willing to accept the legal responsibilities of being a trustee.	Are an existing SMSF trustee who no longer wants to or is unable to undertake trustee responsibilities due to travel or old age.
Want to manage your own super with minimal costs.	Are a disqualified person.

Going overseas? Your residency status and tax

Among the thousands of Australians who head offshore each year to expand their horizons, a lucky few will fund their adventure by working overseas. Many will also take or be given the option to up-stumps and move to a foreign country to live and work for an extended period. But there is often confusion about the tax implications that can arise from taking advantage of such offshore opportunities.

Australian residents are taxed on their worldwide income, whereas non-residents are taxed only on Australian-sourced income. Non-residents are not eligible for the \$18,200 tax-free threshold, so all assessable income is taxed right from the first dollar, and there are also variances in the tax rates applied (the differences between the taxation of residents and non-residents, and the factors used to determine residency status, were touched upon in our August 2012 newsletter).

In cases where an Australian goes overseas for employment, even for some years, the maintenance or relinquishment of resident status can be a key factor in maintaining a favourable, or otherwise, tax outcome. Another factor to keep in mind is the tax law of the country in question, or whether there exists a “double taxation agreement” with this country.

A double taxation agreement sets out which country has the rights to tax each type of income that may be earned – to minimise the chances of being taxed in Australia due to having status as a resident, but also being taxed in the other country under their laws on the same income. The rules in these agreements generally take precedence over the local tax laws of each country. Where the agreement gives the other country the right to impose tax, the income earner is subject to the taxation laws of that country. It is important to know which countries have such agreements, and the outcomes expected because of them, so consult this office should you have questions.

In the case where an Australian takes up a post overseas but retains a domicile in Australia, the Tax Office is likely to consider that the taxpayer retains residency for tax purposes. Some recent Administrative Appeals Tribunal cases have upheld this view. Should however the taxpayer rent out their home here or otherwise divest themselves of their domicile, due to an extended time of overseas employment, it is more likely that the Tax Office will consider them as a foreign resident for tax purposes for the period they are out of the country. The outcomes are very much determined on a case-by-case basis.

If you remain an Australian tax resident

Any income that comes from working outside Australia – including salary, wages, commissions, bonuses and allowances – is regarded as foreign employment income (which may be paid by a foreign or an Australian employer). As an Australian resident, this foreign employment income is in the vast majority of cases taxable in Australia and has to be included in your Australian tax return.

However, if you have paid tax on that employment income overseas, you should be able to claim some or all of the foreign tax as a credit against the Australian tax liability, so that you are not double-taxed. The mechanism for this is the “foreign income tax offset”, which you can claim for the foreign tax paid (converted to Australian dollars) on income, profits or gains (including gains of a capital nature) that are included in Australian assessable income. In some circumstances, the offset is subject to a limit, which generally broadly equates to the amount of Australian tax that would be payable.

To be entitled to a foreign income tax offset:

- you must have actually paid, or be deemed to have paid, an amount of foreign income tax
- the income or gain on which you paid foreign income tax must be included in your assessable income for Australian income tax purposes.

Certain aid workers, Australian Defence Force personnel, and employees of certain tax-exempt Australian institutions may be entitled to a full tax exemption on their foreign employment income if they worked overseas for at least 91 days.

If you cease Australian tax residency

As a non-resident you will only need to submit an income tax return if you have Australian-sourced income — and there is no need to lodge a return if the only Australian-source income you receive is interest, dividends or royalties that has had the correct amount of non-resident withholding tax deducted and remitted.

All Australian-sourced interest, dividends and royalties derived after you ceased to be an Australian resident are subject to the non-resident withholding tax provisions. Basically, the payer of the income has to withhold tax (at varying rates) on your behalf and you receive the income net of the withholding tax. As the withholding tax is a final tax, the income should not be included in your Australian tax return. *Continued* ➔

As a non-resident, if you dispose of assets you would only be subject to capital gains tax (CGT) if the asset qualifies as “taxable Australian property”. This includes Australian real property and certain holdings of shares in companies that have a majority of their assets as Australian real property. Further, when you become a non-resident, you are deemed to have sold all your CGT assets that aren’t taxable Australian property for

market value at that time. So it is theoretically possible to pay the tax before you sell the asset, although you can generally choose to defer the tax until you actually divest the asset or become an Australian resident again.

And remember, non-residents of Australia are not required to pay the Medicare levy, so you can claim the number of days that you are not an Australian resident during a tax year as exempt days in your tax return. ■

R&D Tax Incentive: Tips on how to apply for it

In an effort to boost the spirit of innovation in Australian businesses, the government’s Research and Development (R&D) tax incentive offers businesses a way to get back some of their R&D spend. Broad-based without being industry-specific, businesses can use the tax offset to influence on the scope and timing of their R&D expenditure levels. The current tax offset arrangement replaced the previous R&D concession and applies to financial years beginning on or after July 1, 2011.



The incentive has two core components. Businesses carrying out R&D may be eligible for:

- a 45% refundable tax offset (equivalent to a 150% deduction) for eligible entities with an aggregated annual turnover of less than \$20 million, provided they are not controlled by income tax exempt entities, or
- a 40% non-refundable tax offset (equivalent to 133% deduction) for all other eligible entities (entities may be able to carry forward unused offset amounts to future income years).

But some business owners may be confused about what the R&D tax incentive entails. The Tax Office believes that uncertainty exists regarding who is eligible for the incentive, whether they should apply for the R&D incentive or R&D concession, and what amount is taken into account when determining the offset.

A few points to remember are:

- Certain businesses may have a substituted accounting period (SAP) to provide financial statements to overseas parent companies with different accounting periods. This allows a business to prepare only one financial statement that can simultaneously be used to prepare both their income tax return as well as report their results to their overseas parent company.
- If your 2011-12 tax return is for a SAP beginning before July 1, 2011, you are unable to claim the R&D tax incentive in your 2011-12 tax return. However, if you have conducted R&D activities before July 1, 2011 and meet the eligibility requirements for the R&D tax concession, you can claim the R&D tax concession for that year.
- Businesses can only obtain the R&D tax incentive for expenditure they incur to an associate when they pay the amount. If you incur an amount of expenditure to an associate and pay the amount in the same year, you can take this amount into account when working out your R&D tax offset in that year. Of course, this is provided you meet all other eligibility requirements for the R&D tax incentive.

To help you with your R&D queries, the Tax Office has compiled a list of answers to the most frequently asked questions. *Continued* ➔

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Can I claim the R&D tax incentive if my income year begins before July 1, 2011 but ends after July 1, 2011?

No. The start date for the R&D tax incentive is determined by when your income year begins, not when it ends. If your income year begins before July 1, 2011, you cannot claim the R&D tax incentive until your first year of income beginning on or after July 1, 2011.

I have an early-balancing December substituted accounting period with an income year from January 1, 2011 to December 31, 2011. Can I claim the R&D tax concession from January 1, 2011 to June 30, 2011 and the R&D tax incentive from July 1, 2011 to December 31, 2011?

No. The R&D tax incentive only applies to income years beginning on or after July 1, 2011. If eligible, you will be able to claim the R&D tax concession for your 2011-12 income year and claim the R&D tax incentive for your 2012-13 income year.

I'm unable to claim the R&D tax incentive in my 2011-12 income tax return as my 2011-12 income year begins before July 1, 2011. How do I claim the R&D tax concession for the 2011-12 income year?

Early balancers are unable to lodge their 2011-12 R&D tax concession claim electronically so you must lodge paper versions of both the 'Research and development tax concession schedule 2011' and 'Company tax return 2011', clearly marking them '2012' by crossing out 2011 at the top of these forms and writing 2012. Make sure you use paper versions of both – if not, delays may occur.

I have issued a cheque to my associate, but it was not presented by June 30, 2012. Can I claim a notional R&D deduction for this amount?

"Paid" in relation to the R&D tax incentive includes constructive payments – that is a payment made but not yet reflected in the records of the payee. A personal cheque is taken to be paid when it is received by the recipient, provided it is promptly presented and not refused. It is assumed it is presented promptly if it is presented within a few business days. If payment is made by cheque, payment will not be recorded by the Tax Office until the cheque is cleared.

Can a journal entry be considered payment?

Using a journal entry will not, on its own, constitute payment. A journal entry will only constitute payment if there are mutual liabilities between the two parties and if there is a binding agreement between those parties to set off the liabilities.

My business is a subsidiary in a consolidated group for a full income year, and I contract another member of that group to undertake R&D activities for me. Does the amount under this contract need to be paid prior to claiming a notional deduction amount?

No. The claimant company in this scenario would be the head entity of your group. Provided that the amounts were incurred, and meet all other eligibility criteria for the R&D tax incentive, all amounts incurred by a member of a consolidated group are taken to have been incurred by the head company. Therefore, amounts incurred to other subsidiaries within a consolidated group are not required to be paid prior to being claimed under the R&D tax incentive.

As the questions above illustrate, eligibility requirements for the R&D tax incentive are varied and complex. Consult this office to find out if your business is eligible to access the offset and how to go about it. ■

Are self-funded retirees entitled to a concession card?

The Commonwealth Seniors Health Care Card can give self-funded retirees who do not qualify for a government Age Pension the entitlements that others receive from the Pensioner Concession Card (like pharmaceutical benefits, help with utilities bills and transport discounts). Many self-funded retirees can maintain their assets and continue to make quality investments rather than work out ways to reduce assets to 'get on the pension', even for as little as a dollar a fortnight, just to qualify for the card.

The card is available for people who have attained Age Pension age and have an adjusted annual taxable income not exceeding \$50,000 for a single person or \$80,000 a year combined for a 'couple living together'. The adjusted taxable income limit for a 'couple separated by illness' is \$100,000 a year. These income limits are fixed in legislation and not subject to any form of indexation, and also increase by a certain amount for each dependent child.

Apply to Centrelink only after attaining Age Pension age, but check with this office for more information. ■

Business warned: Tax dos and don'ts

Unsure of what may cause the Tax Office's spider senses to tingle? Small and medium-sized enterprises (SMEs) can unravel the mysteries of the Tax Office's compliance regime now that it has released detailed information that confirms what SMEs should and should not do. The Tax Office pays attention when there are:

- substantial differences between tax performance and business performance
- inconsistencies in activity statements
- spikes in refund claims
- large, one-off or unusual transactions (international transactions, financial supplies or property-related transactions)
- significant differences between the tax and economic performance of one business to similar businesses in the same industry
- unexplained losses
- histories of aggressive tax planning
- weaknesses in compliance structures, processes and approaches
- tax outcomes inconsistent with intent of tax law
- lifestyles not supported by after-tax income
- treatment of private assets as business assets
- access of business assets for tax-free private use
- non-disclosure of offshore dealings with overseas entities in low-tax jurisdictions and tax havens
- usage of complex structures and intra-group transactions to minimise tax
- poor governance and risk management systems
- distortions and inconsistencies in market valuations and apportionments, and
- business performances falling outside small business benchmarks.

The Tax Office uses a risk differentiation framework to assess the threat of each taxpayer. By using the framework, the Tax Office has categorised all taxpayers in the SME segment into four risk categories:

- **lower-risk taxpayers** – includes the majority of businesses in the SME market. These taxpayers can expect periodic monitoring from the Tax Office, information requests, and internal reviews
- **medium-risk taxpayers** – are subject to periodic reviews and compliance-verification activities. These taxpayers typically partake in a practice the Tax Office has taken an interest in, such as making unusually large claims

- **key taxpayers** – typically includes taxpayers who approach the Tax Office for a ruling on a contentious tax matter. They may be subject to ongoing monitoring
- **higher-risk taxpayers** – includes highly wealthy individuals but depends on the nature of their transactions, their effective tax rate and their compliance history. Can expect close scrutiny, audits and a higher level of intensity in interactions with the Tax Office.

On a related note, the Tax Office's 2011-12 prosecution program showed that 514 businesses were nabbed for lodging false business activity statements (BAS), making false fuel tax credit claims, incorrectly using an Australian Business Number and participating in the illegal transfer of money into offshore accounts.

Below are a few case studies which demonstrate how exactly businesses erred in 2011-12:

- **Lodgements of false BAS:** A Queensland-based woman lodged BAS for multiple businesses and claimed fraudulent refunds on her activity statements. She was sentenced to two years imprisonment and had to pay the \$55,000 equivalent to the refunds she had received.
- **Theft of personal details to submit false BAS:** A NSW man stole the identities of seven businesses and registered ABNs for them. He then submitted BAS forms and claimed false GST refunds for these businesses. The refunds were paid into bank accounts he set up in the names of the stolen identities. He was convicted and sentenced to three years jail.
- **False fuel tax credit claims:** A Queensland man claimed a total of \$1.5 million false fuel tax credits by claiming he purchased diesel fuel for transport vehicles which he owned and hired to transport goods. The Tax Office's sleuthing revealed that many of the vehicles he claimed for were not transport vehicles, but instead normal sedans, and that his businesses were for storage of goods rather than transportation. The man was convicted and sentenced to six years jail and ordered to pay \$1.37 million.
- **Offshore fraud:** Three NSW co-directors of an air conditioning business used illegal "round-robin" schemes, where money labelled as "company expenses" was transferred to a Vanuatu account and returned "tax-free" to the co-directors' personal accounts. They were all sentenced to varying periods of jail. ■