
Tax and Superannuation Update – Winter 2003 Edition

Small Business CGT Concession - what's new?

Thinking about selling up? There is massive CGT relief available. Of strong interest are the CGT concessions available to small business owners when disposing their "active" business assets.

The early baby boomers are now looking at retirement. This means selling out of the family business. You want to avoid paying CGT. The Taxman wants you to pay as much tax as possible. Thankfully, for Tax Lawyers there are plenty of grey areas. These are made even greyer by the recent ATO comments and Interpretive Decisions (IDs).

The Concessions

The now 3-year-old small-business CGT concessions are in Division 152 of the *Tax Act 1997*.

There are 4 concessions that apply when an active asset is disposed of by a small business individual or entity:

- 15 year exemption
- 50% active asset reduction
- 50% retirement concession (maximum \$500,000 per person)
- Small-business rollover

Subject to the business structure that holds the active asset, the small-business CGT concessions are claimed in addition to the general 50% discount (where asset held for at least 12 months). You may get both.

What you need

Let's have a look at the "basic" conditions:

1. Small Business Test - must be under \$5m

This sets a \$5m limit on the net value of assets that you and related entities can own.

Who are the "related entities" and "affiliates"?

Say you are a sole practitioner. Your great millionaire uncle sets up a family trust. You know nothing of that family trust but all of your great uncle's relatives, including you, are potential beneficiaries. You are now connected with the trust.

The trust assets are included in your calculation. The \$5m is based on the market value of net assets.

Assets used solely for personal use and enjoyment by an individual are excluded as are an individual's superannuation interests and the value of insurance policies.

All family trusts created before August 2002 need to be updated to change the entitlement of "charities". Otherwise, as part of the \$5m test, you have to add up all the value of charities in Australia and you automatically fail the \$5m test. We can do this without triggering a resettlement for the Stamp Office and the ATO.

2. Active Asset Test

An active asset is one that is used, or held ready for use, in carrying on a business by you, the small business owner. The business can also be carried on by your connected entities and affiliates. It includes intangible assets inherently connected with the business, such as goodwill. Some assets, for example, rental properties, are specifically excluded from being active assets.

To satisfy the active asset test, the asset is active just before its disposal and during at least half the period that it was owned. Some additional flexibility is provided where assets have been owned for more than 15 years, or disposal occurs within 12 months of the business having ceased.

3. Controlling Individual / CGT Concession Stakeholder

The good news is that shares and trust interests (eg units in a trust) can be active assets. You need to satisfy 2 basic conditions:

1. at least 80% of the market value of all the assets held by the company or trust are active assets. (This is a good reason to try to sell the units or shares in your unit trust or company. You won't get this if you sell the assets directly out of the company or trust.) You may get both the small business and 50% general discount.
2. The company/trust must have a controlling individual, (broadly speaking, an individual with at least 50% ownership) at the time and the disposer must be a CGT concession stakeholder (that is, he controlling individual or his/her spouse).

Recent Developments - Ali Barber and the 40 thieves

The law in this area is a mess. In desperation, the ATO has issued nearly 40 Interpretive Decisions (ID).

Before you think of selling your business, speak with your Accountant, Adviser and Lawyers. If they need the advice of tax lawyers then they can brief us.

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Child Maintenance Trusts

Many marriages end in divorce. More than half the break ups involve children under 18 years of age. The two best times to tax plan are at death and divorce. Before you divorce, do a Binding Financial Agreement. Your Adviser can contact a Tax Lawyer to assist you with this. You can also start preparing your own at www.lawcentral.com.au. After you divorce, if you have young children, you can consider a Child Maintenance Trust ("CMT").

Do I have a legal financial obligation to my children?

Yes you do. When you break up, you have 12 months after the divorce to divide up your booty - either by a Binding Financial Agreement, by consent or the court will decide. You must ensure that any children of the relationship are appropriately provided for.

By consent or in the court order the parties may agree to include a Child Maintenance Trust in the orders.

You also have an obligation for children that come from a one night stand. You don't need to have had a "relationship" with the other parent. You are liable and you can do a CMT in these circumstances.

How does the Child Maintenance Trusts save me tax?

When a child gets "unearned" income their tax rate after \$643 climbs to 66%! However, income from a CMT allocated to the child is treated as 'excepted trust income'. The child is then given, for this income, an adult tax rate.

What do I have to do?

You cease living together on a genuine domestic basis (includes both married and de facto couples). One of you is the child's natural, adoptive, step parent, legal custodian or guardian.

An 'order, determination or assessment' is made wholly or partially because the couple cease to live together.

A 'court, person or body' makes the order, determination or assessment.

The effect of the order is that you become subject to a legal obligation to maintain, transfer property to or do some other thing for the benefit of the child or the spouse.

The 'person' under the legal obligation can be anyone including a company - not just you.

The transfer of the property to the CMT is done to satisfy the legal obligation.



Child Maintenance Trusts – a better way of providing for your child.

The child ultimately receives the trust capital. This is not necessarily when your child turns 18 years of age. It is when the trust ends. Trusts can go for up to 80 years from the date they start. With the help of your Adviser, you can put assets in the CMT that have small capital value at the end of the day. These include annuities and sheep. To see how it all works more information is available from: <http://www.taxlawyers.com.au/manuals/ChildMaintenanceTrust.htm>

His laptop contained my client base

Advisers and Accountants do salary packaging. Your Tax Lawyer then prepares the employment contract to support the packaging. Brett Davies Lawyers prepare many senior executive employment contracts.

We also review many employment contracts. They are mostly out of date. Three years ago, the court allowed an employee to steal the client base because it was on the employee's laptop! The restraint of trade clauses are often so wide as to be unenforceable. Effective employment contracts should also include a clause to stop outgoing employees stealing/enticing away other employees. Most of these issues are never addressed.

Everything is now on the computer: training manuals, documents, pricing schedules, sales strategies, client base and suppliers. You must customise the restraint of trade clause for each level of employee.

Bad documents lead to sadness for all. Take the celebrated WA insurance broker case. The naughty employee didn't get his generous bonus because he stole 50% of his boss' clients within one month of joining the new firm.

Employment contracts should also authorise the employer to monitor all emails, including hotmail, coming onto the office computer.

ACTIONS TO PROTECT EMPLOYERS

1. confidentiality agreements
2. full and proper employment contracts
3. password protect confidential information
4. quarantine & record the actions of the departing employee's computer

Knowledge is too valuable to leave unprotected.

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Succession Planning in a Family Trust - ATO's restrictive resettlement views attacked.

The ATO came up with a terrible story that if you amend any trust deed then that is a "resettlement". You then have to pay CGT on all the assets in your trust. In 2001 the High Court said the ATO's position was silly. Sadly, the ATO said the High Court was talking about only Self Managed Super Funds - their resettlement position stayed.

Family Trusts need an update every 4 years or so. From your family trust, you may want to leave your farm to your daughter and the factory to your son. The ATO makes it hard to achieve either of these.

The deputy sheriff of the ATO - the states' stamp duty offices - have gained confidence in the ATO's unsupportable position. The Victorian stamps office stuck its neck out. It said that a statement by a trustee that reduced the number of discretionary beneficiaries entitled to real property constituted a new trust. Therefore, the trust has to pay stamp duty.

The Victorian Supreme Court disagreed with that position in *Lam & Kym Pty Ltd*.



Is the Stamps Office's favourite money tree under threat?

Facts

As is usual the family trust deed provided for two classes of beneficiaries: primary and general. All the primary beneficiaries were also general beneficiaries. The trust property included land in Melbourne. In 1999, the trustee signed a declaration that it now held the real estate separately for the primary beneficiaries and for only some of the discretionary beneficiaries.

The Commissioner considered that the declaration created a new trust to which the real estate was subject. This is called a resettlement of the land. Full stamp duty is payable on the value of the land!

Decision

The Court held that the declaration did not create a new trust. Despite the declaration, the real estate was held by the same trustee on the same trusts. (Editor: apologies for the technical babble coming up) At most, certain contingent rights were removed, with the result that certain contingent beneficiaries no longer held any contingent interest in the land. Other beneficiaries retained their interests which became slightly less contingent than before.

The trustee had merely exercised its power to decide which beneficiaries would continue to hold the interests in a particular portion of the trust fund. There was no revocation and no new trust and no stamp duty.

This is a great win and opens the door to allow for succession planning to take place in family trusts.

The 3 most common questions on Self Managed Super Funds:

Assuming I have an independent valuer, can I or my family:

1. sell an item we own into the SMSF?
2. buy something out of my SMSF?
3. lease something from my SMSF?

The answer is sadly, no, no & no.

The government claims to be sick and tired of some people selling their junk into the SMSF. They also are fed up with the members buying all the good stuff out of the fund. We therefore all suffer with these harsh rules.

Let me give you an example for number 3 above. Your SMSF buys a Ferrari. It can then lease it out for \$350 per day to the market. Anyone in the whole world can lease that Ferrari. Anyone however except you and your family. Your grandma, without knowing that the SMSF owns the car, leases the car for a naughty weekend. Your SMSF is now in breach!

There are, however, two exemptions to selling stuff into your SMSF. You can sell listed shares. Secondly, you can sell your business real property into the Fund. But it must be used, as a business premises, by a member of the fund. If you own business premises but don't work in the premises then you can't sell it into the SMSF. For more help see ID 2002/987 & ID 2002/986. Alternatively get your lawyer, adviser or accountant to instruct us to have a look at the matter.

You can create your own SMSF 24 hours a day at www.lawcentral.com.au. You gain an education in the process as there are lots of hints throughout the process.