

## Small business CGT concessions & super

The CGT small business concessions allow members to get an extra \$1.1 million each into super. This can be a great way to boost retirement savings given the contribution limits now in place.

Furthermore, these concessions can also be used in conjunction with an asset protection strategy. For example, transferring business real property ('BRP') to an SMSF can allow business owners to take advantage of the CGT concessions and boost their retirement savings with the further advantage of long-term asset protection offered by SMSFs.

### 15 year v retirement exemption

Advisers should think carefully about which of the concessions are available to their clients. For example, will they qualify for the 15 year or retirement exemptions, and what are the advantages of each?

15 year exemption	retirement exemption
capital proceeds can be contributed into super	only the net capital gain may be contributed
up to \$1.1m proceeds can be contributed	up to \$500,000 net gain can be contributed
entire capital gain can be disregarded	up to \$500,000 net gain can be disregarded
only available to those aged 55 years or over (unless permanently incapacitated)	potentially available to those under 55 years
must be in connection with 'retirement' (unless permanently incapacitated)	no need to retire (despite the name 'retirement exemption'!)
asset must have been continuously owned for at least 15 years	no requirement as to period of ownership
if asset owned by a company or trust, must have had a 'significant individual' for a total of at least 15 years	if asset owned by a company or trust, must have had a 'significant individual' but only at time of the CGT event
can apply to a pre-CGT asset	only applies to post-CGT assets

Note, these CGT rules are complex and the table above is a simplified summary only.

### Sale to the SMSF?

Many small businesses may never see any capital gain from goodwill materialise but may have BRP that grows in value. These clients are often keen to contribute BRP to their SMSF if they can overcome some of the CGT, GST and stamp duty hurdles. However, SMSF members should not overlook the possible advantages of simply selling BRP to their SMSF in connection with a Div 152 strategy.

Firstly, although a sale gives rise to stamp duty, in some States and Territories there may be one or even two or more rounds of stamp duty applicable if BRP is contributed (eg, if it must be distributed from a family trust to the members before it is contributed to the SMSF). It may also be possible to transfer the BRP GST-free as a going concern sale (which is not possible if it is contributed).

Further, a sale to an SMSF means the owner receives cash proceeds. Some small business owners need cash to make cash payments to stakeholders which is necessary to claim the retirement exemption.

The financing issue for the SMSF may be a temporary one as sale proceeds may ultimately be contributed back into the SMSF. An SMSF might even use a gearing strategy to acquire the BRP (or alternatively, members might borrow to make non-concessional contributions to help fund the BRP purchase with the sale proceeds flowing back to the members who can then repay their loan in the short-term).

DBA Lawyers will be examining the CGT small business concessions and strategies in detail at our February 2010 workshops. See further information under 'Seminars' at [www.dbalawyers.com.au](http://www.dbalawyers.com.au).

## Can reserves be added to pensions?

The ATO has recently commented on allocations from reserves, providing greater certainty for those who wish to top up existing pensions. (Refer to NTLG Superannuation Sub-Committee minutes of 8/9/09.)

Broadly, the ATO confirms that it is possible to add to an existing pension by way of allocation from reserves. This is possible since an allocation from

reserves is not a 'contribution' or a 'roll-over' for SIS purposes (once a pension has commenced, the capital supporting the pension cannot be added to by way of 'contribution' or 'roll-over'). However, although it is not a 'contribution', an allocation of reserves can count towards a member's concessional contribution cap for tax purposes due to the operation of the tax legislation (see below).

#### *The 'fair and reasonable' 5% test*

Generally, allocations from a reserve will count towards the receiving member's concessional contributions cap, unless an exception applies (reg 292-25.01(4) of the 1997 tax regulations). One exception that can apply is where:

- the amount is allocated, in a *fair and reasonable* manner, to an account for every member (or if the reserve amount relates only to a particular class of members, to an account for every member of the class); and
- the amount allocated for the financial year is less than 5% of the value of the member's interest.

Assuming an allocation is within the 5% limit, the question then arises: if one member has an accumulation account and also a pension (eg, account-based pension ('ABP')), does the trustee have to split the allocation between the two interests in order for it to be 'fair and reasonable'?

The ATO confirms that, to be fair and reasonable, the trustee cannot necessarily just allocate the amount all to one interest (eg, all to the ABP and nothing to the accumulation account). It must be 'fair and reasonable' between the two interests. DBA's view is that 'fair and reasonable' generally means on a proportionate basis, but there may be grounds to allocate on a disproportionate basis if this is fair and reasonable, eg, if there are special circumstances.

#### *How does the allocation affect the component mix?*

The ATO confirms that an allocation from reserves to an *accumulation* interest adds to the taxable component. This is because the 'taxable' component of an accumulation balance is, by definition, anything that is not tax free.

On the other hand, an allocation from a reserve to a *pension* account will simply add to the pension in the same tax free/taxable proportions as the pension

itself. This is because the proportions of a pension are 'locked in' forever on the commencement day of the pension. Therefore, if the pension is 40% tax free, this means an allocation from reserves would also become 40% tax free.

## **SMSF borrowing update**

Instalment warrant-style borrowings by SMSF trustees have experienced a surge in interest in recent months. These arrangements appear to have now become 'mainstream' strategies for many advisers, both direct bank and related party loans.

Advisers should stay tuned for developments in this area as we expect there will be further announcements about borrowing in 2010. Our members will recall that the ATO's draft ruling on 'contributions' (TR 2009/D3) stated that amounts paid pursuant to a guarantee that supports an SMSF loan may be treated as a deemed contribution to the fund in some cases (refer to our June 2009 newsletter). This was part of a broader view expressed by the ATO that a contribution includes anything that increases the capital of the fund.

This ruling is due to be finalised early in 2010 and we understand the ATO may scale back its approach to what amounts to a 'contribution'. This could in turn lead to a revised ATO view on guarantees.

More broadly, with the recommendations of the Cooper review into superannuation due to be handed down in 2010, it is expected that the appropriateness of the borrowing laws will be examined in some form. The borrowing laws have attracted much attention since they were enacted in late 2007 and the Cooper review may focus on SMSFs specifically and whether it is appropriate for SMSFs to be allowed to borrow.

While we cannot speculate, those SMSF clients who are thinking about implementing an SMSF borrowing strategy might consider the possibility of future changes in 2010. Those who have decided to borrow may therefore benefit by locking in a borrowing arrangement prior to any announcement and ensuring they plan with flexibility in mind. Further, some flexibility may exist under a related party borrowing to allow the related party to refinance its borrowings without impacting the SMSF's loan.

DBA provides documentation for both direct bank and related party loans. Please visit our website or contact our office for pricing and information.

For further Information please contact:

**DBA LAWYERS PTY LTD** (ACN 120 513 037) Level 1, 290 Coventry Street, South Melbourne Vic 3205

Ph 03 9092 9400 Fax 03 9092 9440 [dba@dbalawyers.com.au](mailto:dba@dbalawyers.com.au) [www.dbalawyers.com.au](http://www.dbalawyers.com.au)

DBA News contains general information only and is no substitute for expert advice. Further, DBA is not licensed under the *Corporations Act 2001* (Cth) to give financial product advice. We therefore disclaim all liability howsoever arising from reliance on any information herein unless you are a client of DBA that has specifically requested our advice. ACN 120 513 037.