AN UPDATE ON TAX CONCESSIONS FOR SMALL BUSINESS

MARCH 2021

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INTRODUCTION

There are a range of tax concessions available to small business. Previously they were only for businesses that had an aggregated turnover of under $10m. Recent changes to the legislation mean there are now more concessions available and to a much wider net of businesses.

In this seminar I will be doing an overview of the concessions and then looking in more detail at the following:

- the immediate deductibility of start up expenses
- the concession re prepayments
- temporary full expensing
- small business restructure rollover relief; and
- the new loss carryback rules

I have listed the concessions below in a table in order of highest to lowest turnover eligibility.

**Annual turnover** is defined at s 328-120 ITAA to be the total ordinary income that an entity derives in the income year in the ordinary course of carrying on the business. It does not include amounts relating to GST.

**Aggregated turnover** is defined at s 328-115 ITAA as the annual turnover of the taxpayer plus the annual turnovers of any businesses the taxpayer is connected with or its affiliates. This does not include income from dealings with each other

**Connected with** - An entity’s turnover will be aggregated with that of another entity where they are connected ie:

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

Section 328-125 ITAA provides an entity controls a company, individual or fixed trust where it or its affiliates or both:
• have ownership, or have the right to acquire the ownership of interests that give the right to receive at least 40% of any distribution of income or capital or net income of a partnership; or

• if the other entity is a company, have ownership, or have the right to acquire the ownership of interests that give the right to exercise or control the exercise of at least 40% of the voting power in the company, or the right to receive at least 40% of any income or capital the company distributes.

An entity is taken to control a discretionary trust:

• where the trustee acts, or could reasonably be expected to act, in accordance with the wishes or directions of the entity; or

• if for any of the four income years before that income year, the trustee paid at least 40% of any income or capital of the trust to or for the benefit of the entity and/or its affiliates. (Exempt entities and deductible gift recipients are excluded from this test).

If an entity controls a second entity, and that second entity controls a third entity under a direct or indirect control test, the first entity is taken to control the third entity except where the second entity is a listed company, publicly traded unit trust or mutual insurance company.

Affiliates - Section 328-130 ITAA provides only individuals or companies can be affiliates and only if they act, or could reasonably be expected to act,

- in accordance with the entity’s directions or wishes in relation to the affairs of that individual or company’s business; or

- in concert with the entity in relation to the affairs of the individual or company’s business

An individual or company is not automatically an affiliate because of the relationship they have with the taxpayer, or their relationship with an entity that is common to both.

For example, if the taxpayer is a partner, another partner in the same partnership is not an affiliate just because that partner acts, or could reasonably be expected to act, together with the taxpayer in relation to the affairs of that partnership. To be an affiliate, the partner must act in concert with the taxpayer in respect of a business separate from that partnership.

Similarly the following are not automatically affiliates of each other:

- directors of the same company

- the company and the director of the company.
TAX CONCESSIONS AVAILABLE

Concessions currently available are listed below together with the relevant aggregated turnover and date criteria for each one. Note there may be other criteria to be satisfied for a concession to be available. This list does not cover every concession available.

<table>
<thead>
<tr>
<th>TAX CONCESSION</th>
<th>AGGREGATED TURNOVER AND DATE REQUIREMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Temporary full expensing - outright deduction for capital assets until 30 June 2022 – deduction for the business portion of the cost of eligible depreciable assets of any value in the year they are first held, and first used or installed ready for use for a taxable purpose (discussed later). The business portion of the cost of improvements to existing eligible depreciable assets made during this period can also be fully deducted.</td>
<td>Below $5 billion.</td>
</tr>
<tr>
<td>The depreciable asset must be first held, and first used or installed ready for use for a taxable purpose, after 6 October 2020 and on or before 30 June 2022.</td>
<td></td>
</tr>
<tr>
<td>Corporate loss carry back tax offset for 2020-21 and 2021-22 (discussed later)</td>
<td>Below $5 billion</td>
</tr>
<tr>
<td>Instant asset write-off for assets costing under $150,000, acquired from 7:30 pm 2/4/2019 to 31/12/20 and first used/installed between 12/3/2020 and 30/6/2021</td>
<td>Below $500 million</td>
</tr>
<tr>
<td>Accelerated depreciation for new assets first held on or after 12 March 2020 and first used or first installed ready for use for a taxable purpose on or after 12 March 2020 until 30 June 2021</td>
<td>Below $500 million</td>
</tr>
<tr>
<td>Reduced corporate tax rate of 26% in 2020-21. From 2017–18, corporate entities eligible for the lower tax rate are called base rate entities. A base rate entity is a company that both:</td>
<td>Below $50 million</td>
</tr>
<tr>
<td>• has an aggregated turnover less than the</td>
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</table>
aggregated turnover threshold – which is $25 million for the 2017–18 income year and $50 million from the 2018–19 income year; and
• 80% or less of the assessable income is base rate entity passive income – this replaces the requirement to be carrying on a business.

The table below outlines the changes to the turnover threshold in order to qualify for the lower corporate tax rate. If the turnover is over the threshold in the relevant year, the corporate tax rate is 30%.

<table>
<thead>
<tr>
<th>Financial year</th>
<th>Aggregated turnover less than</th>
<th>Company tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015-16</td>
<td>$2m</td>
<td>28.5%</td>
</tr>
<tr>
<td>2016-17</td>
<td>$10m</td>
<td>27.5%</td>
</tr>
<tr>
<td>2017-18</td>
<td>$25m (base rate entities)</td>
<td>27.5%</td>
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<tr>
<td>2018-19</td>
<td>$50m (base rate entities)</td>
<td>27.5%</td>
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<tr>
<td>2019-20</td>
<td>$50m (base rate entities)</td>
<td>27.5%</td>
</tr>
<tr>
<td>2020-21</td>
<td>$50m (base rate entities)</td>
<td>26%</td>
</tr>
<tr>
<td>2021-22</td>
<td>$50m (base rate entities)</td>
<td>25%</td>
</tr>
</tbody>
</table>

**Immediate deductibility for start-up expenses** (discussed later)  
Below $50 million with effect 1 July 2020  
(previously below $10 million)

**Immediate deduction for certain prepaid business expenses** (discussed later)  
Below $50 million with effect 1 July 2020  
(previously below $10 million)

**Simplified trading stock rules** - avoid end of year stocktake if value of the stock has changed by less than $5,000. The value of trading stock on hand at the end of the year will be equal to the value of the trading stock on hand at the

Below $50 million with effect 1 July 2021  
(currently below $10 million)
<table>
<thead>
<tr>
<th>Feature</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 year period for amendment of assessments</td>
<td>Below $50 million with effect 1 July 2021 (currently below $10 million)</td>
</tr>
<tr>
<td>Choice to account for GST using a simplified accounting method (SAM)</td>
<td>Below $50 million with effect 1 July 2021 (currently below $10 million)</td>
</tr>
<tr>
<td>Choice to pay GST and PAYG by instalments based on an instalment amount</td>
<td>Below $50 million with effect 1 July 2021 (currently below $10 million)</td>
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</tr>
<tr>
<td>FBT car parking exemption (s 58GA FBTAA) – car parking benefits</td>
<td>Below $50 million with effect 1 April 2021 (currently below $10 million)</td>
</tr>
<tr>
<td>Exemption from FBT for multiple work-related portable electronic devices</td>
<td>Below $50 million with effect 1 April 2021 (currently below $10 million)</td>
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<tr>
<td>The right to use the ATO Small Business Superannuation Clearing House</td>
<td>Below $10 million or with 19 or fewer employees</td>
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<tr>
<td>Roll-over relief for restructures of small businesses (discussed later)</td>
<td>Below $10 million</td>
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<tr>
<td>Cash accounting for GST</td>
<td>Below $10 million</td>
</tr>
<tr>
<td><strong>Paying GST by quarterly instalments but reporting GST annually</strong></td>
<td>Below $10 million</td>
</tr>
<tr>
<td>---------------------------------------------------------------</td>
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</tr>
<tr>
<td><strong>Annual apportionment of input tax credits that are partly creditable</strong></td>
<td>Below $10 million</td>
</tr>
<tr>
<td><strong>Access to small business pool.</strong></td>
<td>Below $10 million</td>
</tr>
<tr>
<td>Under temporary full expensing, the balance of the small business pool will be a deduction at the end of the income years ending between 6 October 2020 and 30 June 2022</td>
<td></td>
</tr>
<tr>
<td><strong>13% small business income tax offset</strong> up to a maximum amount of $1,000. The small business income tax offset can be claimed by sole traders and those whose who have a share of net small business income from a partnership or trust.</td>
<td>For individuals that have an aggregated turnover &lt; $5 m for the income year and/or whose assessable income for the income year includes a share of the net income, for the income year, of an entity with aggregated turnover &lt; $5 m that is not a corporate tax entity.</td>
</tr>
<tr>
<td>The tax offset increased to 13% (from 8%) in 2020–21 and increases to 16% from the 2021–22 income year.</td>
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</tr>
<tr>
<td>It is worked out on based on the proportion of tax payable relating to the total net small business income.</td>
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</tr>
<tr>
<td><strong>Access to the CGT small business concessions</strong></td>
<td>Below $2 million or net assets less than $6 million</td>
</tr>
<tr>
<td>- <strong>CGT 15-year asset exemption</strong> - a full exemption from CGT on the disposal of an active asset which has been held continuously for 15 years;</td>
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</tr>
<tr>
<td>- <strong>CGT 50% active asset reduction</strong> - 50% exemption on the disposal of active assets;</td>
<td></td>
</tr>
<tr>
<td>- <strong>CGT $500,000 exemption</strong> - exemption of up to $500,000 on the disposal of active assets;</td>
<td></td>
</tr>
<tr>
<td>- <strong>CGT roll-over</strong> - deferral of making of capital gains</td>
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IMMEDIATE DEDUCTIBILITY OF START UP COSTS

Section 40-880(2A) ITAA provides businesses with aggregated turnover below $50 million (with effect 1 July 2020 - previously $10 million) and individuals can immediately deduct certain costs incurred when starting up a business, including government fees and charges and costs associated with raising capital, that were previously only deductible over 5 years under s 40-880 of the ITAA 1997 (black hole expenditure).

What qualifies?

Expenditure that would be deductible over five years under section 40-880 of the ITAA 1997 is fully deductible in the income year in which the expenditure is incurred if the expenditure:

• relates to a business that is proposed to be carried on; and is either:
  – incurred in obtaining advice or services relating to the proposed structure or the proposed operation of the business; or
  – is a payment to an Australian government agency of a fee, tax or charge incurred in relation to setting up the business or establishing its operating structure; and

To the extent an amount is not deductible under s 40-880, including because the amount is deductible under some other provision of the tax law or because the deduction is subject to the rules concerning non-commercial losses, immediate deductibility will not apply.

Immediate deductibility is limited to 2 categories of expenditure:

• expenditure on advice or services relating to the structure or the operation of the proposed business. This includes for example, advice from a lawyer or accountant on how the business may be best structured as well as services such individuals or firms may provide in setting up legal arrangements or business systems for such structures. It also includes professional advice on the viability of the proposed business.

It does not include the cost of acquiring assets that may be used by the business.

• The payment to an Australian government agency (ie the Commonwealth, a State or Territory or an authority thereof – includes local governments) of fees, taxes or charges relating to establishing the business or its operating structure. Broadly, this category of expenditure includes regulatory costs incurred in setting up the new business.
Examples would be the costs associated with creating the entity that may operate the business (such as the fee for creating a company) and costs associated with transferring assets to the entity which is intended to carry on the proposed business (eg the payment of stamp duty).

It does not include expenditure relating to taxes of general application such as income tax.

**THE CONCESSION RE PREPAYMENTS**

For businesses with aggregated turnover below $50 million (with effect 1 July 2020 - previously below $10 million) and individual taxpayers incurring deductible non-business expenditure, the section 82KZM 13 month rule is replaced by a 12 month rule. This allows immediate deductions for prepayments where:

- the eligible service period for the expenditure incurred is no longer than 12 months; and

- the period of service ends no later than the last day of the income year following that in which the payment was incurred.

The eligible service period generally commences on the date on which the expenditure is incurred and ends on the day, or the last day, on which the thing to be done under the agreement in return for the amount of expenditure is required, or permitted, as the case may be, to cease being done.

No deduction is available for the GST component where an input tax credit is available.

If the 12 month rule cannot be taken advantage of, it is necessary to apportion prepayment deductions > $1,000 (which are not excluded expenditure) over the period to which they relate or 10 years, whichever is less.

**Example: Prepaid expense where requirements met**

T Pty Ltd is a business with a turnover of $8 million. On 31 May 2020, it paid $15,000 for business advertising to cover the period 1 June 2020 to 30 May 2021.

The eligible service period is not more than 12 months. The period of service ends before the last day of the income year following that in which the payment was incurred (30 June 2021). The prepayment satisfies the 12-month rule and T Pty Ltd can claim an immediate deduction for the prepayment.
What is excluded expenditure?

Certain types of expenditure are excluded from the prepayment rules. The prepayment rules do not apply to this type of expenditure and the fee is deductible in the year it is incurred. These are:

- amounts of less than $1,000 (generally, prepayments of deductible expenses less than $1,000 each (this is the GST-exclusive amount if the taxpayer is entitled to an input tax credit in respect of the expenditure) can be claimed as tax deductions in the year the prepayment is made. However, beware that the Tax Office will look closely where 2 or more such prepayments are made and may apply anti-avoidance rules)

- amounts required to be incurred by a court order or law of the Commonwealth, state or territory eg. car registration

- payments under a contract of service eg. salary and wages

- amounts that are capital, private or domestic in nature, and

- certain amounts incurred by a general insurance company in connection with the issue of policies or the payment of reinsurance premiums.
TEMPORARY FULL EXPENSING

Currently there is available an outright deduction for the business portion of capital assets until 30 June 2022. It is referred to as temporary full expensing.

Prior to this there was provision for instant asset write off.

<table>
<thead>
<tr>
<th>Previous measures</th>
<th>Business with aggregated turnover &lt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Instant asset write-off for assets costing under $30,000, acquired from 7:30 pm 2/4/2019 to 11/3/2020 and first used/installed between 2/4/2019 and 11/3/2020 (s 40-82 ITAA 1997)</td>
<td>$50m</td>
</tr>
<tr>
<td>Instant asset write-off for assets costing under $150,000, acquired from 7:30 pm 2/4/2019 to 31/12/20 and first used/installed between 12/3/2020 and 30/6/2021 (s 40-82 ITAA 1997)</td>
<td>$500m</td>
</tr>
</tbody>
</table>

Now the position is that there is an immediate deduction for the business portion of the cost of assets first held and first used (or installed ready for use) for a taxable purpose from 7.30 pm 6 October 2020 to 30 June 2022. The instant asset write-off threshold does not apply to these assets.

**Conditions to satisfy for temporary full expensing**

The depreciating asset must be first held, and first used or installed ready for use for a taxable purpose, after 6 October 2020 and on or before 30 June 2022

The deduction is for the business portion of the cost of eligible depreciating assets of any value in the year they are first held, and first used or installed ready for use for a taxable purpose.

The business portion of the cost of improvements to existing eligible depreciating assets made during this period can also be fully deducted. This applies even if those assets were acquired before 7.30 pm on 6 October 2020.

Note however that the car limit for passenger vehicles applies to limit the deduction available. The car limit is $59,136 for the 2020–21 income year.

The asset must be located in Australia and principally used in Australia for the principal purpose of carrying on a business.

In addition, the depreciating assets must not be:
• allocated to a low-value or a software development pool

• certain primary production assets (water facilities, fencing, horticultural plants or fodder storage assets), unless the taxpayer is a small business entity who chooses to apply the simplified depreciation rules to these assets

• buildings and other capital works for which amounts can be deducted under Division 43

The concession is for businesses with an aggregated turnover below $5 billion.

If the entity has an aggregated turnover of $50 million or more, additional exclusions apply. For these entities, a depreciable asset that starts to be held after 6 October 2020 is excluded from outright deduction if:

• the entity entered into a commitment to hold, construct or use the asset on or before 6 October 2020; or

• the asset is a second-hand asset.

Under temporary full expensing, businesses with aggregated turnover less than $10 million also deduct the balance of their small business pool at the end of the income years ending between 6 October 2020 and 30 June 2022.

These businesses need to apply the simplified depreciation rules to claim temporary full expensing. From 7.30pm 12 May 2015 to 30 June 2022, the ‘lock out’ rules are suspended to allow small businesses that choose to stop using the simplified depreciation rules to take advantage of temporary full expensing and the instant asset write-off.

**Balancing adjustment event**

A balancing adjustment amount needs to be included in assessable income if a balancing adjustment event occurs in a year after temporary full expensing for an asset is claimed.

As well as the usual balancing adjustment events, such as ceasing to hold a depreciable asset, a balancing adjustment event will occur under temporary full expensing when it is not reasonable to conclude that:

• the asset will be used principally in Australia for the principal purpose of carrying on a business ie. it ceases to be used primarily for carrying on a business and is instead applied for private use before the end of its effective life; or
• the asset will be located in Australia i.e. the asset is relocated outside Australia after it has been fully expensed and before the end of its effective life.

Accelerated depreciation alternative

From 12 March 2020 until 30 June 2021, the Backing business investment measure provides a 15-month investment incentive by accelerating depreciation deductions.

Businesses with an aggregated turnover of less than $500 million, for the 2019–20 and 2020–21 income years, may be able to deduct the cost of new depreciable assets at an accelerated rate.

Effectively, the backing business investment - accelerated depreciation deduction applies to eligible assets with a cost of $150,000 or more in the:

• 2019–20 income year, if the eligible asset is first held on or after 12 March 2020 and first used or first installed ready for use for a taxable purpose in the 2019–20 income year

• 2020–21 income year, if the eligible asset is first committed to or held on or after 12 March 2020 and first used or first installed ready for use for a taxable purpose in the 2020–21 income year.

Those using the simplified depreciation rules for small business can claim 57.5% (rather than 15%) of the cost of the asset (for those assets that cost more than $150,000) in the first year it is added to the small business pool.

For other businesses that qualify, the amount they can deduct in the income year the asset is first used or installed ready for use is:

• 50% of the cost of the depreciable asset
• plus, the amount of the usual depreciation deduction that would otherwise apply but calculated as if the cost or adjustable value of the asset were reduced by 50%.

The passenger car limit still applies.

Eligible assets are depreciable assets (for example, plant, equipment and specified intangible assets, such as patents) that must:

• be new and not previously held by another entity (other than as trading stock)
• be first held on or after 12 March 2020
• first used or first installed ready for use for a taxable purpose on or after 12 March 2020 until 30 June 2021
• not be an asset to which an entity has applied either
  o temporary full expensing
  o the instant asset write-off rules.

Eligible assets do not include:

• second-hand depreciable assets
• some specific Division 40 assets subject to low value and software development pools
• certain primary production assets
• buildings and other capital works deductible under Division 43
• assets that
  o will never be located in Australia, or
  o will not be used principally in Australia for the principal purpose of carrying on a business
• assets that the business was committed to acquiring before 12 March 2020

Example from ATO factsheet

J Construction Solutions Pty Ltd has an aggregated turnover of $200 million for the 2020–21 income year. On 1 July 2020, J Construction Solutions Pty Ltd installs a $1 million truck mounted concrete pump. For the 2020–21 income year, the pump was only used for business purposes.

The concrete pump was held before 2020 budget time so does not qualify for temporary full expensing. However, it does qualify for backing business investment – accelerated depreciation.

Under past tax arrangements, in the first year J Construction Solutions Pty Ltd could claim 30% depreciation when using the diminishing value method (based on the asset’s effective life of six and two thirds years).

Under the backing business investment –accelerated depreciation, J Construction Solutions Pty Ltd can claim a depreciation deduction of $650,000 in the 2020–21 income year. This consists of 50% of the concrete pump’s value under the backing business investment – accelerated depreciation ($500,000) plus 30% of the remaining $500,000 under existing depreciation rules ($150,000).
Opt out on asset by asset basis

A business can make an irrevocable choice to opt out of temporary full expensing and the backing business investment incentive on an asset–by-asset basis for the purpose of working out its capital allowance deductions for an income year for each eligible asset.

In the case of temporary full expensing, a business makes this choice for a particular depreciating asset for each applicable income year.

In the case of the backing business investment incentive, a business makes this choice for a particular depreciating asset for an income year and subsequent income years. The effect of the choice is different in this case because the backing business investment incentive provides for an accelerated decline in value that has an effect for the first income year as well as subsequent income years.

The choice for both temporary full expensing and the backing business investment incentive must be made in the approved form and must be given to the Commissioner of Taxation by the day the business lodges its tax return for the income year to which the choice for an asset relates.

Despite this concession it appears that businesses must still deduct the balance of their simplified depreciation pool at the end of the income year while full expensing applies.

SMALL BUSINESS RESTRUCTURE ROLLOVER RELIEF (SBRR)

Subdivision 328-G ITAA 97 provides for tax-neutral consequences for a small business (turnover < $10 million) entity that restructures the ownership of the assets of the business, without changing the ultimate economic ownership of the assets.

It does this by "switching off" the application of the existing income tax law - but only for the purpose of the transfer and not for the purposes of GST, FBT or stamp duty.

The roll-over does not require that market value consideration, or any consideration, be given in exchange for the transferred assets.
**Roll-over cost**

The rollover provisions provide the acquirer of the asset (the transferee) is effectively taken to acquire the asset for its roll-over cost (irrespective of the amount paid for the asset).

The roll-over cost is the transferor's cost of the asset for income tax purposes, such that the transfer results in no gain or loss for the transferor.

Section 328-455 specifies the roll-over cost for each type of asset.

**CGT assets**

For the transfer of a CGT asset, the roll-over cost is the transferor's cost base for the asset just before the transfer takes effect. For example if the cost base of an asset is $100 and the market value of the asset is $200, the roll-over cost is equal to $100.

Pre-CGT assets transferred under the roll-over retain their pre-CGT status in the hands of the transferee.

**Trading stock**

To the extent that the asset is trading stock of the transferor, the roll-over cost is the cost of the item for the transferor at the time of the transfer; or if the transferee held the item as trading stock at the start of the income year, the value of the item for the transferor at that time.

Assets that are trading stock of the transferor will be held as trading stock by the transferee. The transferee will inherit the transferor's cost and other attributes of the assets as the transferor just before the transfer.

**Revenue assets**

The roll-over cost is the amount that would result in the transferor not making a profit or loss on the transfer. The transferee will inherit the same cost attributes as the transferor just before the transfer.

**Depreciating assets**

The roll-over cost for a depreciable asset is the transferor's adjustable value just before the transfer takes effect.

The transferee can deduct the decline in value of the depreciable asset using the same method and effective life (or remaining effective life if that method is the prime cost method) as the transferor used.
Example from Law Companion Guideline LCG 2016/2 – Transfer of assets

A company transfers its assets to a discretionary trust. The company carries on a naturopathy business. The company and the trustee choose to apply the SBRR.

As at 1 January 2021, the active assets of the company are:

- a small consulting room, which was acquired by the company for $200,000 in 2018. No other additional capital expenditure has been outlaid in relation to the room. The market value is $230,000.
- goodwill, which is self-generated
- a pill pressing machine, with an adjustable value of $14,000, and
- 50 bottles of homeopathic pills, which are trading stock during the income year at a cost of $250.

The effect of applying the rollover is:

- no capital gain or loss arises from the transfer of the consulting room. The trustee is taken to have acquired the consulting room at the time of the transfer for $200,000, being the company’s cost base for the asset immediately before the transfer takes effect.
- no capital gain or loss arises from the transfer of the goodwill. The trusteed is taken to have acquired the goodwill at the time of the transfer for $0, being the company’s cost base for the goodwill immediately before the transfer takes effect.
- the pill pressing machine is a CGT asset that is a depreciating asset. No amount is included in the company’s assessable income, or deduction allowed, as a result of the transfer of the pill pressing machine. The roll-over cost for a depreciating asset is the transferor’s adjustable value just before the transfer takes effect. The adjustable value is $14,000. The trustee can deduct the decline in value of the pill press using the same method and effective life (or remaining effective life, if using the prime cost method) as the company was using.
- the homeopathic pills are trading stock. As a result of the disposal of the pills to the trustee, the company is taken to have transferred the pills for their cost ($250) and not for their market value. The company includes $250 in its assessable income under section 70-90.

No dividend arises as a result of the transfer of CGT assets (that are not depreciating assets) by the company (including any ‘deemed dividend’ under Division 7A of Part III of the ITAA 1936 or any other provision of the tax law).
Membership interests (shares and units)

Where membership interests are issued in consideration for the transfer of assets, the cost base of those new membership interests will be:

- the sum of the roll-over cost of assets transferred that are not pre-CGT or depreciable assets; plus
- the adjustable values of the transferred depreciable assets
- less any liabilities the new entity has undertaken to discharge associated with those assets and any other consideration given
- divided by the number of membership interests.

Effect of roll-over on acquisition dates of assets

With the exception of pre-CGT assets which retain their pre-CGT status following a restructure, assets transferred as a part of the restructure have a refreshed acquisition date being the date of the restructure.

This means that the availability of the general 50% CGT discount is pushed back at least 12 months from the date of the restructure.

Necessary elements for the rollover to be available

Section 328-430 provides a rollover under Subdivision 328-G is available where the following is satisfied:

- an Australian resident small business entity or associated entity (as defined)
- transfers active assets
- to one or more other entities that are Australian resident small business entities or associated entities (as defined)
- the ultimate economic ownership ("UEO") of the assets (directly or indirectly) does not change;
- the assets are transferred as part of a genuine restructure of an ongoing business; and
- the transferor and each transferee choose to apply the roll-over in relation to the assets transferred.

Active assets

The EM states the roll-over applies to gains and losses arising from the transfer of active assets that are CGT assets, depreciable assets, trading stock or revenue assets between entities as part of a genuine restructure of an ongoing business.

Section 328-430 requires the asset to be an active asset at the time the transfer takes effect.
The section does not appear to require that the asset be an active asset for the lesser of half the period of ownership or 7 1/2 years as is the case with the CGT small business concessions.

An active asset is defined in section 152-40 ITAA 97 as being an asset, owned by the taxpayer (tangible or intangible) and:

- used or held ready for use in the course of carrying on a business eg. the business premises owned by the operating entity; or
- used or held ready for use in the course of carrying on a business by the taxpayer’s affiliate; or another entity connected with the taxpayer
- if the asset is an intangible asset – it is owned by the taxpayer and it is inherently connected with a business that the taxpayer, its affiliate, or another entity connected with the taxpayer, carries on (for example, goodwill).

**Rental properties generally excluded**

Unfortunately that section states that assets that are specifically excluded from being an active asset include **assets whose main use is to derive interest, annuities, rent, royalties or foreign exchange gains unless its main use for deriving rent is temporary.**

Assets used mainly to derive rent are excluded from being an active asset even if they are used in the course of carrying on a business (eg commercial premises rented to tenants) - **TD 2006/78, AAT Case [2013] AATA 526, Re Jakjoy Pty Ltd and FCT.**

This exclusion means that rental properties will generally not qualify for the SBRR.

However where the premises are used in the course of carrying on a business by a connected entity or an affiliate they will be an active asset.

**Example from TD 2006/63**

Joe owns 100% of the shares in Smash Repair Co, which carries on a panel beating business. Joe and the company are therefore connected with each other. Joe also owns the business premises and leases them to the company for the conduct of its business.

Although Joe is wholly using the premises to derive rent, Smash Repair Co (a connected entity) is wholly using them in the course of carrying on a business. The premises are therefore an active asset of Joe’s under subparagraph 152-40(1)(a)(iii) of the ITAA 1997.
Shares and units

There are extra requirements for shares in companies or interests in trusts to qualify as active assets for the purposes of the SBRR – especially see s 152-10(1A). This means that where the transferor of the shares/units is not a SBE, it will be difficult for the transfer of shares or interests in trusts to qualify for the SBRR. This is illustrated by an eg from LCG 2016/13.

Example from LCG 2016/3

Di provides accommodation services. She operates the business through a company, Backpackers Co, of which she is the sole director and shareholder.

Di decides to reorganise the ownership interest in her business by interposing a non-fixed trust between herself and the company. On 1 August, Di transfers all of her shares in the company to the Trustee of a newly-settled discretionary trust, where she is one of the beneficiaries. The family trust election is made with herself as the primary individual.

Backpackers Co is a small business entity. Di is not a small business entity but is connected with Backpackers Co.

Backpackers Co is not a party to the transfer. The shares are not active assets of a small business entity. Di and the Trustee are parties to the transfer and connected with Backpackers Co. However, the transferred shares are not active assets used, or held ready for use, by Backpackers Co in the course of carrying on its business, nor are they inherently connected with that business.

Consequently, the SBRR is not available and Di would need to consider the capital gains tax position from the disposal of her shares.

Ultimate economic ownership

To be eligible for the roll-over the transaction must not have the effect of changing the ultimate economic ownership of transferred assets in a material way.

The ultimate economic owners of an asset are the individuals who, directly or indirectly, beneficially own an asset.

Ultimate economic ownership of an asset can only be held by natural persons. Therefore, where a company, partnership or trust owns an asset it will be the natural person owners of the interests in these interposed entities that will ultimately benefit economically from that asset.

Where an individual operates as a sole trader, they hold the UEO. Where the entity is a company, the provisions will look at the ultimate shareholders to determine the UEO.
**Same proportionate ownership requirement**

If there is more than one individual who is an ultimate economic owner of an asset, there is an additional requirement that each of those individuals’ shares of that ultimate economic ownership be materially unchanged, maintaining the same proportionate ownership in the asset.

**Example from EM**

Amy, Anna and Adrian run a delivery business as equal partners and want to transfer their interests in the assets of the partnership to a company. Anna and Adrian are a couple.

Amy, Anna and Adrian establish a company, whereby 300 identical shares are issued. 100 shares are issued to Amy, 150 shares are issued to Anna, and 50 shares are issued to Adrian. This is because Adrian has other income and Anna and Adrian, as a couple, want to lower their overall income tax bill.

While this doesn’t change the individuals who have the ultimate economic ownership of the asset, there is a change in the proportionate share of that ultimate economic ownership. Accordingly, Amy, Anna and Adrian cannot use the small business restructure roll-over.

However, if the shares were distributed equally between the partners, the ultimate economic ownership of the assets would be unchanged, and Amy, Anna and Adrian could use the roll-over, subject to satisfying the other conditions.

**Special rule for discretionary trusts**

Section 328-440 states a transaction does not have the effect of changing the ultimate economic ownership of an asset, or any individual’s share of that ultimate economic ownership, if:

(a) either or both of the following applies:

   (i) just before the transaction took effect, the asset was included in the property of a non-fixed trust that was a family trust;

   (ii) just after the transaction takes effect, the asset is included in the property of a non-fixed trust that is a family trust; and

(b) every individual who, just before the transfer took effect, had the ultimate economic ownership of the asset was a member of the family group relating to the trust or trusts referred to in paragraph (a); and

(c) every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that family group.
Example from LCG 2016/3 - Restructure from company to discretionary trust

Steven operates a business through a company structure. Steven and his wife, Vicki are the directors. Steven and Vicki hold 100 ordinary shares in the company. Daniel, their son, holds 100 A class shares while Courtney, their daughter, holds 100 B class shares.

The company transfers the business' active assets to a trust where he and his family members are beneficiaries. A family trust election is made and Steven is the primary individual specified in the election. Steven, Vicki, Daniel and Courtney are all members of Steven's family group.

The company can use the SBRR to transfer its assets to the trust.

Genuine restructure

The EM states the following factors would indicate a "genuine" restructure:

- a bona fide commercial arrangement undertaken to enhance business efficiency
- the business continues to operate after the transfer, through a different entity structure but under the same UEO
- the transferred assets continue to be used in the business
- the restructure results in a structure likely to have been adopted had the business owners obtained appropriate professional advice when setting up the business
- the restructure is not artificially or unduly tax driven

The SBRR is not available to small business owners who are restructuring in the course of winding down or realising their ownership interests.

There is a "safe harbour" rule that provides a transaction will be taken to be part of a genuine restructure if, in the 3-year period after the transaction takes effect:

- there is no change in the UEO of the significant assets of the business (other than trading stock) that were transferred;
- those significant assets continue to be active assets; and
- there is no significant or material use of those assets for private purposes.
LOSS CARRYBACK RULES

Division 160 ITAA provides that corporate tax entities with an aggregated turnover of less than $5 billion can carry back a tax loss for the 2019-20, 2020-21 or 2021-22 income years and apply it against tax paid in a previous income year – as far back as the 2018-19 income year and generate a refundable tax offset in the current year.

For the 2019-20 income year, claims will be processed when income tax returns are lodged for 2020-21 and 2021-22.

A company must have lodged an income tax return for the current year and each of the 5 years immediately preceding the current year in order to claim the loss carry-back.

The amount of the refundable tax offset available is based on the entity’s tax rate in the loss year.

The tax rate for companies other than base rate entities is 30%. However, base rate entities (ie those with aggregated turnover of less than $50 million) have a decreasing rate to factor in:

- if the loss is the 2019-20 income year – 27.5%;
- if the loss year is the 2020-21 income year – 26%; or
- if the loss year is the 2021-22 income year – 25%.

The amount cannot exceed:

- the amount of earlier tax paid by the company; and
- the company's franking account balance at the end of the income year for which the refundable tax offset is claimed ie. the maximum amount of the loss carry-back tax offset for a year will be limited by the surplus balance of the company's franking account at the end of the current year. There will also be a debit for the company's franking account balance for each loss carry-back tax offset that is claimed, which is recorded when the refundable tax offset assessment is made.

The choice under the temporary loss carry back measure must be to carry back a specified fixed dollar amount of an entity’s tax loss to an earlier income year. An entity cannot, for example, specify that it will carry back a percentage of a tax loss.

A company that has net exempt income in an income year that it carries a loss back to must first reduce the carry-back loss by that net exempt income before it works out its offset for the remaining amount of the loss.
Capital losses cannot be carried back.

**Example**

Company A makes a tax loss of $2 million in the 2019-20 income year. In the 2020-21 income year, Company A makes another tax loss of $500,000.

Company A’s franking account balance at the end of the 2020-21 income year is $550,000.

In the 2018-19 income year, Company A had taxable income of $5 million. Company A had no net exempt income in that income year.

As Company A had an aggregated turnover of less than $50 million in each of the relevant income years, it was liable to tax at the base rate entity corporate tax rate in each income year. In the 2018-19 income year, the base rate entity corporate tax rate was 27.5 per cent. Therefore, Company A paid income tax of $1,375,000 for that income year.

Company A makes a loss carry back choice to:

- carry back the tax loss of $500,000 for the 2020-21 income year to the 2018-19 income year; and

- carry back the tax loss of $2 million for the 2019-20 income year to the 2018-19 income year.

The loss carry back tax offset component for the 2018-19 income year is $680,000 – that is, the sum of:

- $130,000, being the amount worked out by applying the method statement in section 160-10 for the 2020-21 income year – that is, $500,000 x 26 per cent (the base rate entity corporate tax rate for the 2020-21 income year); and

- $550,000, being the amount worked out by applying the method statement in section 160-10 for the 2019-20 income year – that is, $2 million x 27.5 per cent (the base rate entity corporate tax rate for the 2019-20 income year).

As the result of the method statement in section 160-10 is less than its income tax liability for the 2018-19 income year ($1,375,000), Company A’s loss carry back tax offset component for that income year is $680,000.

However, the amount of the loss carry back tax offset component exceeds the balance in Company A’s franking account at the end of the 2020-21 income year ($550,000). Therefore, when Company A lodges
its income tax return for the 2020-21 income year, it will be entitled to a refundable loss carry back tax offset of $550,000 – that is, the lesser of:

- $680,000 – that is, Company A’s loss carry back tax offset component for the 2018-19 income year; and
- $550,000 – that is, the balance in Company A’s franking account at the end of the 2020-21 income year.

If Company A’s loss carry back choice does not reflect this position, it can modify the choice to reduce the amount of tax losses carried back. As a result, the unutilised amount of the loss ($130,000) can be carried forward and deducted in future income years.