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SELLING YOUR SMALL BUSINESS

WHAT DOES IT MEAN FOR YOUR TAX?

You've built a good solid business and now it's time to enjoy the fruits of your undoubted labour. So, you sell and make a capital gain – but do you have to pay tax on this? Fiducian's technical services manager, **Richard Press**, says the answer is maybe not.

If you're classified as a small business owner there are a series of concessions that might help you to minimise, and possibly even eliminate the liability of Capital Gains Tax (CGT).

Who/what is a small business entity?

An entity (person, trust or company) is a small business entity for an income year if:

- it carries on a business in the current year, and the aggregated turnover for the current year is likely to be less than $2 million, or
- it carried on a business in the previous income year and the aggregated turnover for the previous year was less than $2 million.

Alternatively, your business might meet the maximum net asset value test. For a small business entity to satisfy the maximum net asset value test, the net value of the assets of the small business, must not exceed $6 million.

So you've determined you are a small business. What are these small business concessions? There are three that may apply to help manage this situation. The CGT small business concessions are the:

- 15-year exemption
- 50% active asset discount
- retirement exemption

The 15-year exemption

The 15-year exemption is the most attractive of all the concessions because:

- the entire capital gain is disregarded
- claiming the concession does not use any capital losses, and
- the entire proceeds from the sale of active assets, up to $1,415,000 (lifetime limit for 2016-17) may be contributed to super and be exempt from the non-concessional contribution cap.

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Inside this issue...

RESIDENTIAL PROPERTY – WHAT COULD GO WRONG?

Stuart Cartledge, Managing Director, Phoenix Portfolios Pty Ltd, an underlying mandate manager for the Fiducian Property Securities Fund

Residential property, particularly in Sydney and Melbourne, has been one of the best performing asset classes in the last few decades. What is the problem with this? We believe pricing is close to or at a cyclical peak, at least in Australia's two largest cities.

Australians have rarely seen house price falls, having largely escaped the dramas in the US following the Global Financial Crisis, or the post-boom meltdown that the UK delivered in the late '80s. Furthermore, Australian housing has benefited from a tax regime that encourages extensive use of debt to finance ever-expanding cities to cater for a strongly expanding population (due to high immigration), enabling investors to offset negatively geared losses against ordinary earned income. For owner-occupied homes, capital gains are tax-free, making home ownership an attractive investment choice for many.

In addition to favourable tax treatment, falling interest rates in recent years have driven asset prices higher, both in absolute terms and also relative to income. This is particularly important for residential housing, given it represents such a basic human need. Chart 1, sourced from the RBA Financial Stability Review document published in April 2017, shows how the ratio of dwelling prices to average household disposable income has moved over the last 40 years.

While I appreciate there are measurement issues that sometimes obscure the data, we can conclude that for many countries, the ratio has moved strongly higher over this extended period of time.

The interaction between interest rates and house prices is partly depicted in Chart 2, which shows that while household debt to income has grown substantially, enabling higher prices, this has been made possible via lower interest rates, such that the repayments-to-income ratio has remained reasonably steady.

What could go wrong?

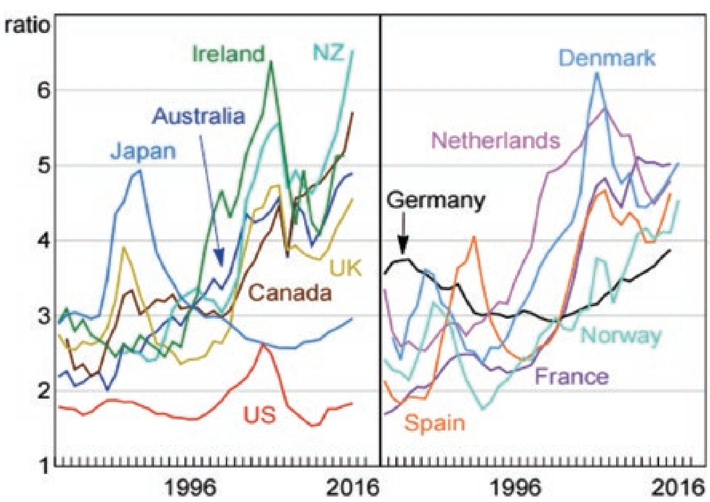
- Government policy settings could change such that the favourable inducements to invest in residential property could be reduced or removed
- Interest costs could rise further, making debt serviceability tougher
- Over-pricing could become more extreme, ultimately self-correcting, potentially in a dramatic fashion

The May 17 Commonwealth Budget contained some steps to assist first-home buyers with a tax-effective saving opportunity, albeit given a $30,000 cap on the scheme, its effectiveness is likely to be limited. There were also measures to encourage increases in housing supply, which could, all else equal, put some downward pressure on prices.

Phoenix is mandated to invest in commercial property via listed Real Estate Investment Trusts (REITs) and as a result, our exposure to residential property is indirect and via holdings in stocks with development exposure, such as Mirvac, Stockland and Lend Lease. As such, our clients have benefited from very strong volumes and margins from development and given a very high level of pre-sales activity, we have reasonable clarity that strong earnings could be delivered for several years to come. Ultimately this could be a safer way to gain exposure to property than through direct leveraged investment in residential property.

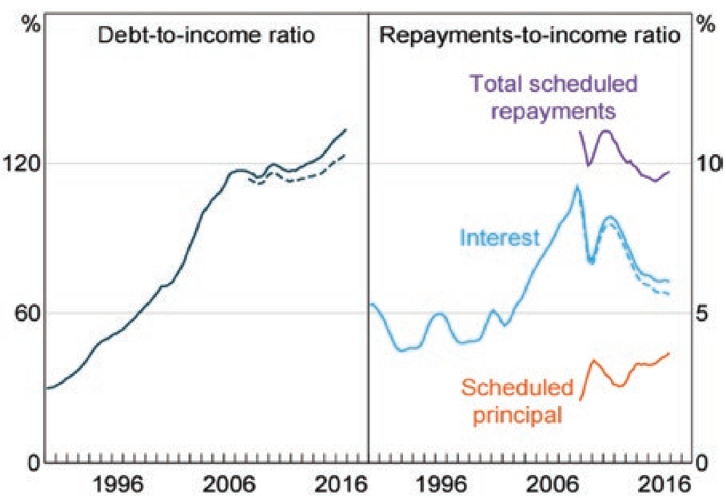
However, whether through direct or indirect investments, we must always be cognisant of the risks.

Chart 1: dwelling prices to average household disposable income



Source: RBA Financial Stability Review, April 2017

Chart 2: housing mortgage debt indicators*



SELLING YOUR SMALL BUSINESS

WHAT DOES IT MEAN FOR YOUR TAX? CONTINUED

However, to be entitled to the 15-year exemption you also need to meet the following criteria:

- You must have continuously owned the asset for the 15-year period ending just before the sale of your business
- You must be 55 or over at the time of the sale and that sale must be ‘in connection’ with your retirement or you must be permanently incapacitated at the time of the sale
- In the case where the CGT asset is a share or an interest in a trust (usually a unit trust), the company or trust must have had a significant individual for a total of at least 15 years.

Where all the conditions for the 15-year exemption are satisfied, the capital gain arising from the sale of the business is exempt from tax.

50% active asset discount

I’ve only owned my business for 10 years, what can I do? Even if you do not qualify for the 15-year exemption, you may qualify for the 50% active asset discount.

Before applying the active asset discount:

- apply current-year and carried-forward capital losses against the capital gain
- apply the 50% CGT discount, if the asset has been held for at least 12 months.

Applying the 50% CGT discount and the 50% active asset discount effectively reduces the capital gain by 75%.

Whilst the 50% active asset reduction is usually applied as a matter of course, you may choose not to apply the 50% active asset discount. It could be beneficial, for example, to not apply for the 50% active asset discount to maximise the capital gain to which the retirement exemption is applied, so you can contribute more to superannuation.

Retirement exemption

What about that last 25%, can I do anything about that? The final exemption you can look to – the small business retirement exemption – allows you as a small business owner to disregard a capital gain of up to $500,000.

Generally you will be required to contribute the exempt capital gain, in cash or by transfer of property, to super. However, if you are over 55, the tax-free gain can be taken in cash or by transfer of property.

What do I do now?

Various options might apply to you if you sell your business. Maybe this is a good time to contact your Fiducian planner and talk with them about what options might apply to you, and how you might best benefit from these concessions.

“You’ve built a good solid business and now it’s time to enjoy the fruits of your undoubted labour”

CASE STUDY

Let’s say your capital gain is $600,000. How do these concessions help?

If you’re over 55 and have owned the business for more than 15 years, you can elect to negate the whole gain under the 15-year concession. But, if you’re not over 55, or you haven’t owned the business for 15 years, then you need to consider the other concessions that may apply.

Firstly, there is the general 50% reduction. This will reduce your capital gain to $300,000. Then you can apply the 50% active asset concession, reducing your capital gain to $150,000.

You can then apply the retirement exemption to the remaining $150,000 and either contribute this to superannuation, or if you are over 55 either contribute this amount to super, or take this as a payment.

FIDUCIAN IN THE COMMUNITY

KONNIE RAISES $2,200 FOR VBA THROUGH BONDI AND COOGEE SWIMS/DOG-PADDLES

Konnie's 2.4km swim around Wedding Cake Island boosted her confidence so much that she did the 1km swim Bondi Blue Water Challenge on Sunday, 30 April.

She says that the Bondi swell was even harder than the Coogee swim. There'd been some rough conditions in Sydney waters since the Thursday before that lasted through the weekend with some beaches closed to swimming.

Konnie takes up the story: As we entered the sea there were 2.5m walls of waves approaching in very quick sequence. The walls of water were hard to penetrate. The surf was incredibly big and powerful!

I'd scramble through one wave, only to be hit by the next. Finally, I made it through by dog-paddling and breast-stroking to the end of the race against very big and choppy swell.

On that note, I would like to say a massive thank you to all of you who have supported me with kind words and who contributed to my $2,000 donation target for VBA.

Actually, we've managed to collect $2,200 – so, thankyou to all of you who sponsored me. The sight of more than 60 people will now be improved through eye operations. And, the bigger picture is that their families will be helped also by that sight restoration.

So, from the bottom of my heart, I sincerely thank you.

http://visionbeyondaus.org.au/

STUNNED MULLETS RAISE MONEY FOR SPECIAL SCHOOLS

In mid-May, FFS Sunshine Coast's Peter Allen co-sponsored a team of renegade retirees from the infamous swimming club, the Stunned Mullets.

Amazingly, the team of five (plus their kayak-paddler) swam the 10km circuit finishing last but to a rousing reception at the end. Not a bad effort from a group who included a 78 year old.

The event raises funds for two special schools on the Sunshine Coast and has been going since 2001. Since that time, more than $1million dollars has been raised for the kids.

The Mullets did raise the question of FFS Sunshine Coast's Peter Allen putting a team in next year. So please let us know if anyone is interested.

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