

# Alert

## TAX

# Small Business

## Flexibility to restructure to be enhanced

By Julie Van der Velde

On 5 November 2015 the Commonwealth Treasury released exposure draft legislation to implement the 12 May 2015 Budget announcement that a roll-over would be introduced to allow small businesses to change their legal structure without incurring a capital gains tax (CGT) liability. The Tax and Superannuation Laws Amendment (2015 Measures No 6) Bill 2015: Small business restructure rollovers (the Bill) is drawn even more widely than the original announcement suggested. Not only can CGT assets be transferred without a tax cost but an entire business can be moved to another entity without CGT and also without tax on the transfers of trading stock, depreciating assets or other revenue assets.

Given the recent State budget announcements in South Australia there is a very real prospect that significant restructures could take place without prohibitive tax costs.

The Bill introduces a new concept into tax law; the concept of "roll-over cost". An asset's roll-over cost is defined in proposed sub-section 328-430(2) as an amount which:

- for a CGT asset would result in neither a CGT gain nor a capital loss;
- for trading stock is its value at the start of the relevant year, or cost if acquired during the year; or
- for revenue assets results in no profit or loss on disposal.

When the roll-over applies the entity that transferred the asset is deemed to receive the roll-over cost and so have no federal tax consequences. The entity which acquires the asset has a cost base equal to the roll-over cost. This could be a welcome relief for a corporate entity which had significant goodwill with no cost base. By transferring the business to individual shareholders or a trust for the individual shareholders the goodwill is transferred with no tax consequence and the new owners will, unlike the company, be eligible for the general 50% discount.

If a business is transferred by a company or unit trust this could mean that the holder of shares or units could make a capital loss after the transfer. To prevent this happening there is a provision which reduces the cost base of shares or units in the entity transferring the business. For example, if a company did transfer its business to a partnership of individuals the shareholders would, if the company had owned nothing but the business, be left with worthless shares. After the roll-over the cost base of the shares would be reduced by the value of the roll-over. If this would result in the shares having a negative cost base their cost base is reduced to zero.

The new roll-over can be used by individuals, partnerships, companies and trustees provided they meet the requirements outlined in the draft law. An eligible entity includes a small business (one with a

turnover of less than \$2 million) which also has, together with connected entities and affiliates, \$6 million or less in net assets. An entity connected with that small business or one which is its affiliate as that term is defined in Division 328 of the legislation will also be eligible.

Both the transferor and the acquiring entity must be Australian tax residents and the ultimate owners of both entities must be Australian tax residents. Finally, the new law will require that the ultimate economic ownership of the asset remains unchanged.

This last requirement could mean that discretionary trusts could not use the new roll-over as the beneficiaries of a discretionary trust have no interest in the underlying assets and so are not ultimate economic owners. However, there is a proposed concession that where a transferor discretionary trust has made a family trust election (FTE) and the transferees are all members of the family group in relation to that election it will be considered that there is no change in the ultimate economic ownership and the trustee can access the rollover. Similarly, if persons or entities are members of the family group in relation to a trust which has made a FTE those persons or entities can use the roll-over to transfer assets to that family trust. Despite the obvious benefits of the roll-over it is still worth considering the significant and generally permanent restrictions imposed by a FTE; they should never be made lightly.

*continued overleaf...*

Tax exempt bodies and superannuation funds are specifically excluded as eligible transferees under this legislation.

The following examples show where the new roll-over could significantly enhance the structure of a small business:

- A factory building was acquired in the same company as the active business. This gives the building no asset protection and the general discount will not apply to any capital gains made on sale of the building. By rolling over the factory building to a trustee which has made a FTE or to individual shareholders both issues can be solved. If both the new federal legislation and the state budget are passed as expected, from 1 July 2018 there will be neither tax nor duty costs on the transfer.
- A business commences in a discretionary trust but grows and needs external funding. Access to venture capital and wider sources of funds may be obtained by using the new rollover to transfer the business to a corporate structure. Assuming the business holds no land there will be neither tax nor duty on the rollover.
- A business commences in a unit trust but is innovative and wishes to develop new processes and products. The business can restructure to a corporate entity in order to access the R & D concessions. Assuming the business holds no land there will be neither tax nor duty on the rollover.
- A business is commenced in a complex structure with several entities and the administrative and compliance burden is found to be greater than any benefits of the structure. The new roll-over can be used to rationalise the structure and so reduce the ongoing costs of operations. Assuming the business holds no land there will be neither tax nor duty on the rollover.

- An individual starts a business in her own name and is more successful more quickly than she ever expected. The roll-over can be used to move that business to a more appropriate structure, giving better asset protection, more access to funding and a better tax environment for the reinvestment of profit. Assuming the business holds no land there will be neither tax nor duty on the rollover.

The new law is expected to apply from 1 July 2016.

For more information on the possibilities the roll-over could open up for your business please contact Julie Van der Velde or any of the DW Fox Tucker Tax team.



**MORE INFO**

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