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[Insert Client Name]

[Insert Client Position]

[Insert Company Name]

[Insert Company Address]

[Suburb State Postcode]

Dear [Insert Client Name]

**Re: Small business entity: Tax concessions**

From a tax planning perspective, eligible small business entities are able to access numerous tax concessions which provide either tax relief and/or simplified tax compliance.

**Executive summary**

This letter sets out the key tax concessions available to an eligible small business entity which carries on a business whose aggregated turnover is less than $10 million for the year ended 30 June 2021 (or later years). As a result of changes enacted following the 2020-21 Federal Budget, certain small business entity concessions now also apply to entities with an aggregated turnover between $10 million and less than $50 million. In addition, an immediate deduction for certain qualifying depreciating assets may be available for entities with an aggregated turnover of less than $5 billion.

Also discussed below is when a company will be regarded as a base rate entity with an aggregated turnover of less than $50 million which will enable the company to apply a lower 26% company tax rate in calculating its income tax liability for the 2021 year. As noted below, the tax rate for base rate entities with an aggregated turnover of less than $50 million will decrease to 25% for the year ended 30 June 2022 and later years.

However, it is important to note that the eligibility criteria to access the small business CGT concessions is more restrictive in that a business taxpayer must have an aggregated turnover of less than $2 million in order to access the concessions where the $6 million maximum net asset value test is not met.

Furthermore, there is a separate $5 million aggregated turnover threshold for an individual carrying on a business via an unincorporated entity which must be met for an individual to directly or indirectly access the small business tax offset.

Each of these categories of concession are discussed further below.

**General definition of small business entity**

The first issue to consider is whether an entity would be regarded as a ‘small business entity’ as defined under section 328-110 of the *Income Tax Assessment Act* *1997* (***ITAA 1997***) for the purposes of claiming concessions other than the small business CGT concessions and the small business offset.

An entity is a small business entity under section 328-110 if it:

* carries on a business
* satisfies the $10 million aggregated turnover test.

Where access to certain concessions has been extended for entities with an aggregated turnover of up to $50 million, the reference to $10 million in the relevant concession has been modified to $50 million.

*Carrying on a business*

The circumstances under which an entity will be regarded carrying on a business for the purposes of section 328-10 of the *ITAA 1997* is a question of fact.

The key indicia considered in determining whether the activities carried on by a person amounts to the carrying on of a business are:

* whether the person intends to carry on a business
* the nature of the activities, particularly whether they have a profit-making purpose
* whether the activities are repeated and regular, and organised in a business-like manner, including the keeping of books, records and the use of a system
* the size and scale of a company's activities including the amount of capital employed in them
* whether the activity is better described as a hobby, or recreation.

The Commissioner has considered whether a company is carrying on a business in a general sense for the purposes of section 328-110 under Taxation Ruling TR 2019/1.

The Commissioner adopts the view in TR 2019/1 that a company may be regarded as carrying on a business for the purposes of section 328-110 of the *ITAA 1997* even if its activities are relatively limited and only consist of passively receiving investment income. In reaching this conclusion the Commissioner accepts that a company will normally be carrying on a business in a general sense if it is established and maintained to make a profit for their shareholders, and it invests its assets in gainful activities that have both a purpose and prospect of profit.

*Aggregated turnover*

An entity’s aggregated turnover is the total of the annual turnover of an entity, its affiliates and entities connected with it.

For these purposes, an entity’s annual turnover is the total ordinary income that the entity derives in the ordinary course of carrying on a business and excludes Goods and Services Tax (**GST**).

It is important to recognise that in calculating an entity’s ‘aggregated’ turnover it is necessary to not only include the entity’s annual turnover but also the annual turnover of any entity which was an affiliate or a connected entity of the taxpayer for the year being tested. Certain intra-group transactions among such entities are excluded from the aggregated turnover calculation to ensure that there is no double counting of annual turnover.

An affiliate includes an individual or company that acts in accordance with the wishes and directions of the entity, or who acts in concert with the entity in relation to the business of the individual or the company.

By contrast an entity will be connected with another entity if either entity controls the other entity, or both entities are commonly controlled by a third entity. A taxpayer will generally control another entity where the taxpayer and/or the taxpayer’s affiliates directly or indirectly beneficially own at least 40% of any right to be distributed income or capital by that entity or have the right to exercise at least 40% of the voting power in the company.

Where an entity is eligible to be regarded as a small business entity, it will be able to potentially utilise the tax concessions detailed below, provided it also satisfies any additional criteria that may separately apply to each concession.

**Outline of small business entity concessions**

The following concessions are potentially available to any entity which is regarded as a ‘small business entity’ (**SBE**), being an entity carrying on a business whose aggregated turnover is less than $10 million. Where these measures apply to entities with a turnover of $10 million or more, this has also been indicated below. As the extensions to the concessions differ in relation to their application dates, the relevant dates or income years have also been provided.

1. *Simplified depreciation rules*

As part of the response in relation to the economic impact of COVID-19, the Government introduced temporary full expensing (TFE) measures to allow businesses to claim an immediate deduction for the full cost of eligible assets. In addition, further amendments were made to the existing instant asset write-off (IAWO) and introduced the backing business investment (BBI) accelerated deprecation regime.

The availability and interaction of the different measures depends upon turnover thresholds, type of asset, when the asset was acquired, etc. The ATO have released a handy guide explaining the rules which we have reproduced at Appendix A.

It is critical in preparing a SBEs income tax return to note that the amount of the deduction for TFE or IAWO is determined by the time during the income year in which the SBE first uses the asset, or installs it ready for use, for a taxable purpose.

It should be noted that the TFE and instant asset write-off (IAWO) in respect of cars is limited to the business portion of the car limit for the relevant income year. The car limit is $59,136 for the year ended 30 June 2021. If a vehicle is used for 75% business use, to total that can be claimed under the instant asset write-off is 75% of $59,136, which equals $44,352.

Entities can opt out the TFE rules on an asset by asset basis. It is also possible to opt out of the BBI rules on an asset by asset basis (unless the entity is using the simplified depreciation rules). This may be preferred where an entity does not want to incur a loss for a particular income year, e.g. where it wants to pay tax in order to receive franking credits to allow it to pay franked dividends. Where an entity chooses to opt out it must make the choice in an approved form by the day that the income tax return is lodged for the income year to which the choice relates.

Where an SBE has opted out of the TFE rules, the IAWO rules will still apply if the entity applies the simplified depreciation rules. It is possible for an SBE to opt out of the simplified depreciation rules for the 2021 income tax return, however the general small business pool balance will still be claimed under the TFE rules.

1. *Loss carry back*

The loss carry back rules provide companies with aggregated turnover of less than $5 billion the option to carry back a tax loss for the 2020, 2021 and 2022 income years.

The amount of the loss carry back for the 2020, 2021 and 2022 income year is limited to the lesser of the amount of tax paid in earlier income years, being the 2019, 2020 or 2021 income years (as relevant) and the amount of the franking account balance at the end of the income year the loss carry back is being applied. The losses that can be carried back are multiplied by the prevailing company tax rate in the loss year to determine the amount of the non-refundable offset.

It was announced in the 2021-22 Federal Budget that the loss carry back measure will be extended to the 2023 income year.

3. *Prepaid Expenses*

From 1 July 2020, entities with an aggregated turnover of less than $50 million can claim an immediate deduction for prepaid expenses for a service period of 12 months or less, which ends in the following income year. For example, prepayments of subscriptions to professional associations, rent or insurance payments are immediately deductible. This is in addition to the normal allowance for prepayments consisting of expenses that are:

* less than $1,000 (GST exclusive)
* required to be made by a Commonwealth, State or Territory law or court order
* payments made under a contract of service e.g. salary and wages.

4. *Simplified trading stock rules*

Provided that the difference between the value of the opening trading stock and the estimated closing stock of small business is $5,000 or less, an SBE does not have to account for changes in value of the trading stock. Otherwise, the entity must conduct a stocktake and account for changes in value at the end of the income year.

Entities with an aggregated turnover of less than $50 million are also able utilise the simplified trading stock rules for income years starting on or after 1 July 2021.

5. *Immediate deductibility of start-up expenses*

Certain start-up costs being business capital expenditure incurred in relation to a proposed business can be written off as an immediate deduction by an entity with an aggregated turnover of less than $50 million under section 40-880(2A) of the *ITAA 1997*. Such expenses include the cost of obtaining legal or accounting advice as to how the proposed business may be structured or operated as well as certain fees charged by an Australian government agency in relation to establishing the proposed structure.

6. *Pay As You Go (PAYG) instalment amounts*

An SBE is eligible to calculate PAYG instalments based on the gross domestic product (GDP) adjusted notional tax method, which may provide compliance savings.

Entities with an aggregated turnover of less than $50 million are also able to calculate PAYG instalments using this method for income years starting on or after 1 July 2021.

7. *Goods and Service Tax (GST) cash accounting*

An SBE can opt to account for GST on a cash basis rather than an accrual basis.

This measure has not been extended to entities with an aggregated turnover of $10 million or more.

8. *GST and annual private apportionment*

When claiming GST input tax credits for business assets, an SBE does not have to estimate how much it intends to use the assets for private purposes. Instead, it is required to make a single adjustment after the end of the income year to account for private use.

This measure has not been extended to entities with an aggregated turnover of $10 million or more.

9. *GST instalments*

An SBE can choose to pay GST by instalments and lodge a GST return annually. Depending on the nature of the business, the frequency of the instalment payments may be four quarterly instalments in an income year.

This measure has not been extended to entities with an aggregated turnover of $10 million or more.

10. *GST simplified accounting methods*

The Commissioner allows eligible entities to access simplified accounting methods in certain situations.

These simplified methods will also be available to entities with an aggregated turnover of less than $50 million from 1 July 2021.

11. *Fringe benefits tax (FBT)*

An SBE can access the FBT car parking exemption provided that the car parking is not provided in a commercial car park.

An SBE can also provide their employees with multiple work-related portable electronic devices that have substantially identical functions in the same FBT year, and all of the devices will be exempt from FBT. This applies to devices that are primarily used for work, such as laptops, tablets, calculators, GPS navigation receivers and mobile phones.

Both of these measures will also apply to entities with an aggregated turnover of less than $50 million in respect of benefits provided on or after 1 April 2021.

12. *Small business restructure rollover relief*

Optional rollover relief is available under Subdivision 328-G of the *ITAA 1997* where an SBE transfers an active asset of the business (e.g. goodwill) to another SBE on or after 1 July 2016 as part of a genuine business restructure where there has been no material change in the underlying economic ownership of assets. The effect of the rollover is to defer any gain or loss arising from the transfer of active assets that are CGT assets, depreciating assets, trading stock or revenue assets where all the requirements of Subdivision 328-G are satisfied. This could be advantageous where the business has evolved and should now be conducted in a different and more appropriate form of legal entity. However, care must be taken to ensure that the various eligibility conditions required to access the rollover are satisfied.

The rollover relief is only available to entities with an aggregated turnover of less than $10 million.

13. *Amendment period*

An SBE generally has a 2 year period in which the Commissioner may amend its income tax assessment.

Entities with an aggregated turnover of less than $50 million will have their assessment period reduced from 4 years to 2 years in relation to assessments for income years starting on or after 1 July 2021.

**Lower 26% company tax rate**

Apart from the above concessions it should also be noted that the company tax rate is 26% for the tax year ended 30 June 2021 for a company which qualifies as a base rate entity. The rate decreases to 25% for the year ended 30 June 2022.

A company will be regarded as being a base rate entity if no more than 80% of the company’s assessable income comprises ‘base rate entity passive income’ and its ‘aggregated turnover’ is less than $50 million. For these purposes aggregated turnover is only calculated on the relevant annual turnover of the company and its affiliates and connected entities for the current year.

A company’s ‘base rate entity passive income’ includes the following:

* distributions (e.g. dividends) other than non-portfolio dividends. A non-portfolio dividend is defined under section 317 of the *Income Tax Assessment Act 1936* (***ITAA 1936***) to mean a dividend paid to a company where that company has a voting interest amounting to at least 10% of the voting power in the company paying the dividend
* franking credits attached to dividends
* non-share dividends
* interest income or a payment in the nature of interest (except interest income derived by an entity which is a financial institution such as a Bank or a Co-operative Housing Society or an entity that holds an Australian credit licence or is a financial services licensee in certain circumstances)
* royalties and rent
* deferred and discounted gains on Division 16E qualifying securities
* net capital gains (as defined under section 995-1(1) of the *ITAA 1997*)
* amounts included in partnership or trust income distributions of net income to the extent that they are attributable to base rate entity passive income under one of the preceding items which has been on-distributed to a company which is a partner in a partnership or a company which is a beneficiary of a trust.

Accordingly, an amount that flows through a partnership or trust to a company (either directly or indirectly via other interposed partnerships or trusts) will retain its character in the hands of the company for the purposes of determining whether or not that amount is base rate entity passive income of the company.

Hence, it is necessary to analyse and dissect partnership and trust distributions (including distributions via a chain of trusts and partnerships) to determine the nature of the income which is received by the company where it is either a partner in a partnership or a beneficiary of a trust.

Law Companion Ruling LCR 2019/5 provides that if a company is assessed on a share of net income of a trust or partnership it will have base rate entity passive income to the extent that the amount is included in assessable income as a trust or partnership distribution. However, where the distribution comprises a mixture of base rate entity passive income and trading income it also confirms that it will be necessary to allocate expenses in a fair and reasonable way particularly in relation to indirect costs such as overheads.

Once it is determined that the appropriate company tax rate is either 26% (or 25% for the year ended 30 June 2022) or 30%, all of the income derived by the company will be subject to tax at the applicable rate regardless of whether such income is base rate entity passive income or not.

**Small business CGT concessions**

Whilst access to the above concessions has been broadened to apply to a small business entity whose aggregated turnover is less than $10 million or $50 million (as applicable) there has been no change to the $2 million aggregated turnover threshold for an SBE wishing to apply the small business CGT concessions under Division 152 of the *ITAA 1997*.

Some further detail on the small business CGT concessions is outlined below.

*Basic eligibility conditions*

An entity will only be able to satisfy the basic eligibility conditions of Division 152 for the year ended 30 June 2021 where it is a ‘CGT small business entity’ being a small business entity whose aggregated turnover is less than $2 million in the year in which the entity triggers the capital gain where that entity does not otherwise satisfy the $6 maximum net asset value test.

In addition, where a taxpayer is either a CGT small business entity or satisfies the $6 million maximum net asset value test it will only be able to potentially claim the small business CGT concessions if the following basic conditions have been satisfied:

* the capital gain relates to an active asset used in carrying on a business
* the active asset has been used in carrying on a business for at least half the ownership period where it has been held for less than 15 years, or for at least seven and a half years where it has been owned for 15 years or more
* certain additional conditions are satisfied where the CGT asset is either a share in a company or an interest in a trust[[1]](#footnote-1).

*Additional conditions for shares and trust interests*

Additional basic conditions must be satisfied where there is a disposal of shares in a company or an interest in a trust in relation to a CGT event on or from 8 February 2018.

The relevant tests that must now be met include the following:

* the taxpayer must be a CGT concession stakeholder in the object company or trust where such interests are directly held by the taxpayer. Alternatively, an interposed entity will be eligible to claim the concessions where one or more CGT concession stakeholders indirectly have an interest in the object entity owned by the interposed entity, and CGT concession stakeholders together have a small business participation percentage of at least 90% in that interposed entity
* the taxpayer must have carried on a business just before the CGT event unless the taxpayer satisfies the $6 million maximum net asset value test.
* the object entity must be a CGT small business entity for the income year or must satisfy the $6 million maximum net asset value test
* the shares or interests in the object entity must satisfy a modified active asset test that looks through shares in companies and interests in trusts to the activities and assets of the underlying entities, and adjusts the control percentage from 40% to 20%.

The practical application of the above additional conditions to the disposal of shares and trust interests is extremely complex especially where the relevant company or trust in which the shares or trust interests are sold are part of a multi-tiered group. Accordingly, it is strongly recommended that specialist advice be sought concerning the application of these provisions in reducing a capital gain on the sale of shares or trust interests under the small business CGT concessions.

Where all the basic eligibility conditions under the CGT small business concessions are met a taxpayer can potentially access the concessions, although additional conditions must be met if certain concessions are claimed by the taxpayer.

*Specific concessions*

The four small business CGT concessions comprise:

* the 15 year exemption
* the active asset 50% reduction
* the retirement exemption
* the small business rollover.

Further details on each of these concessions is provided below

1. 15 year exemption

An individual taxpayer satisfying the basic conditions can disregard a capital gain under the small business 15 year exemption if that person also owned the asset continuously for 15 years and was aged over 55 and was either retiring or is permanently incapacitated. Companies and trusts will similarly be able to disregard a gain where the basic conditions are met, the relevant active asset has been held continuously for at least 15 years, the company or trust had a significant individual for at least 15 years and there was a significant individual of the company or trust just before the CGT event who was over 55 and retiring or permanently incapacitated. Where this concession is available there is no need to reduce the capital gain by capital losses or apply the CGT Discount or other small business CGT concessions.

2. Active asset 50% reduction

The small business 50% active asset reduction is available if the basic eligibility conditions to claim the small business CGT concessions are satisfied as there are no additional eligibility conditions which must be met in applying this concession. The concession operates on the basis that any gross capital gain must first be reduced by capital losses. The resulting capital gain (if any) is then reduced by the CGT Discount (if applicable). Any remaining balance of the capital gain is then reduced by 50% under the active asset reduction. The application of this concession can also be used in combination with the CGT retirement exemption and small business replacement asset rollover.

3. The retirement exemption

If the basic conditions are met, an individual taxpayer may choose to disregard a capital gain under the CGT retirement exemption up to a lifetime CGT retirement exemption limit of $500,000 where that individual is aged 55 or over. However, where such a taxpayer is aged less than 55 at the time of choosing the concession the amount of any exempted gain up to the above $500,000 threshold must be paid to a complying superannuation fund or a retirement savings account. In addition, a company or a trust can also choose to claim the retirement exemption. However, in these circumstances it will also be necessary to ensure that the significant individual test is satisfied just before the CGT event occurs, and that the amount of any gain is paid by the company or trust directly to the CGT concession stakeholders of the company or trust who will be subject to the above rules concerning the $500,000 retirement exemption.

4. Small business rollover

Where the basic conditions are met, a small business entity can also choose to indefinitely defer a capital gain if it applies the small business replacement asset roll-over. Where an entity chooses this concession, it must acquire replacement active asset(s) and/or improve existing active asset(s) within two years of the sale of the active asset. If this does not occur, a capital gain will arise to the extent that the deferred capital gain is not applied to acquire replacement and/or improved active asset(s) within two years from the date of sale of the active asset.

*Concession for superannuation contributions*

Contributions arising from the disposal of assets that qualify for the 15 year CGT exemption and the $500,000 CGT retirement exemption under the small business concessions may be contributed to a complying superannuation fund without breaching the non-concessional contributions cap provided they do not exceed a combined lifetime CGT cap amount which increased to $1,565,000 for the 2021 tax year (and increases to $1,615,000 for the 2022 tax year).

**Small business tax offset**

A small business entity that is not a company is entitled to a tax offset provided its aggregated turnover for the year ended 30 June 2021 is less than $5 million.

The small business tax offset is a non-refundable tax offset of the income tax payable by an individual on any net small business income which is included in that individual’s taxable income. The offset is available not only when an individual is a small business entity but also where an individual is a beneficiary of a trust or a partner in a partnership which is an eligible small business entity.

The amount of the small business tax offset is equal to 13% of the income tax payable on that part of an individual’s taxable income that represents ‘total net small business income’. The amount of the offset is capped to a maximum annual amount of $1,000 for each individual regardless of the number of sources of net small business income that individual may derive. The amount of the small business tax offset will increase to 16% for the year ended 30 June 2022, however the $5 million aggregated turnover threshold and the $1,000 cap still apply.

Given the above concessions, there may be substantial benefits potentially available to your business if you are a small business entity.

If you would like to discuss how the small business tax concessions may affect your business or have any further queries, please do not hesitate to contact [insert name] on [insert telephone number].

Yours faithfully

**[Insert name of Partner]**

Appendix A





Note it was announced in the 2021-22 Federal Budget that the TFE measures have been extended to 30 June 2023.

1. A taxpayer can also satisfy the basic eligibility conditions where an asset the taxpayer owns is used in a business carried on by an affiliate or an entity connected with the taxpayer even though the taxpayer does not carry on a business. However, such a test will only be met where the affiliate or connected entity is a CGT small business entity in the relevant year in which the gain was made, or the entity owning the asset meets the maximum net asset value test just before the CGT event. [↑](#footnote-ref-1)