FARM BUSINESS FACT SHEET

GRDC GRAINS RESEARCH & DEVELOPMENT CORPORATION

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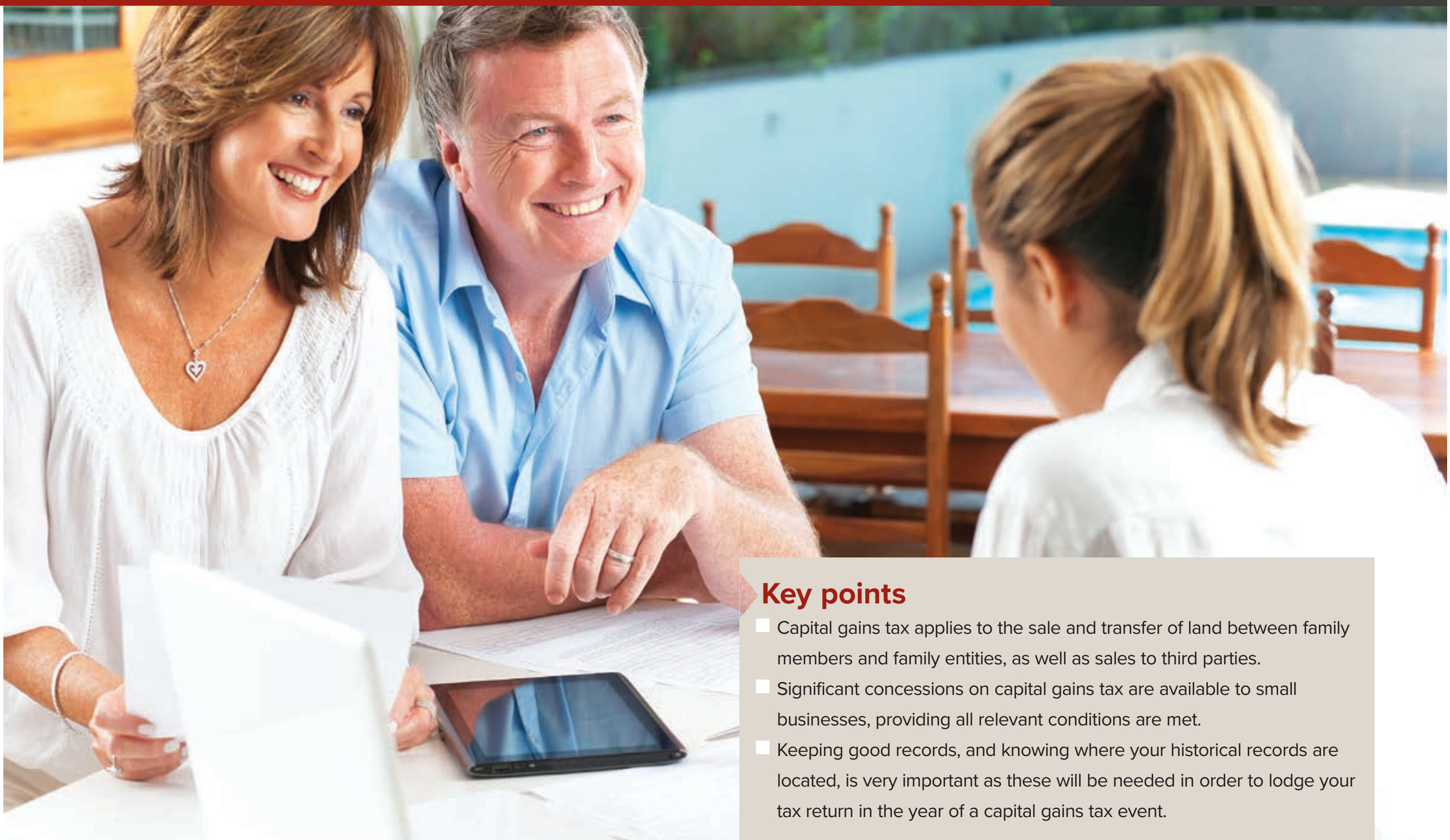

Key points

- Capital gains tax applies to the sale and transfer of land between family members and family entities, as well as sales to third parties.
- Significant concessions on capital gains tax are available to small businesses, providing all relevant conditions are met.
- Keeping good records, and knowing where your historical records are located, is very important as these will be needed in order to lodge your tax return in the year of a capital gains tax event.

Capital gains tax (CGT) implications on the sale or transfer of farmland

Introduction

Capital gains tax (CGT) was introduced in 1985 and applies to any capital assets sold or transferred after that date. Any farm succession plan or farm sale can be impacted by CGT and a good understanding of the options available to the owner prior to the sale or transfer is important.

What are the laws?

The CGT provisions generally apply to CGT events (the types of transactions or events that result in a capital gain or loss) that happen to CGT assets (e.g. land, shares in a company, units in a unit trust, other assets unless specifically excluded) acquired by a taxpayer after 19 September 1985. A capital gain arises from the sale of an asset when capital sale proceeds exceed the costs associated with acquiring the asset. A capital loss arises when the sale proceeds are less than the costs of acquiring and holding the asset. A capital loss may only be applied against any current or future capital gains and cannot be applied against other types of income.

In many cases the small business CGT concessions are available to the person or entity disposing of an asset. There are certain conditions around turnover and maximum net asset values that must be met to access these concessions. With careful planning, many farming families have been able to avail themselves of these concessions. In general terms, turnover of the family group needs to be less than $2 million in the year of disposal of the asset and/or have net assets less than $6 million. Importantly, it should be noted that the definition of a 'small business' for CGT small business concessions is different to that of the general definition of a 'small business entity' for tax purposes.

An 'active asset' test must also be passed in order for the asset (such as farmland) to be deemed eligible for the concessions. In general terms, this means that farmland, for example, must be used in farming for a specified period of time during the period of ownership to qualify for the concessions. Passive investments, such as shares and land that has been leased and not farmed, would not meet the active asset requirement and therefore would not qualify for the small business concessions.

The four concessions are:
1. the 50 per cent active assets exemption;
2. the 15-year asset exemption;
3. the retirement exemption; and
4. the business asset rollover concession.

THE 50 PER CENT ACTIVE ASSETS EXEMPTION

For individuals and trusts a capital gain can be discounted by 50 per cent if the asset has been held for more than 12 months. Certain superannuation funds are eligible for a 33.3 per cent discount on assets held for more than 12 months. No such discount applies for companies. Assets such as your car, and other depreciable assets, are exempt from CGT. Your home or main residence is also generally exempt. To qualify for a full main residence exemption, the residence must have been the home of you, your partner and other dependents for the whole time you owned it; must be on less than two hectares of land; and you must not have conducted a business from it (including renting it out). It is rare that the family home on a farm would meet the conditions for main residence exemption (given the business is often conducted from the house); however, in some circumstances it may apply.

THE 15-YEAR EXEMPTION

Providing the taxpayer has met the basic conditions for small business concessions, that is the 'active asset' and the 'turnover' or 'net asset' test, then the capital gain arising from an asset owned by the taxpayer for more than 15 years may be exempt, provided certain conditions are met including the following:

- The entity must have continuously owned the asset for the 15-year period leading up to the sale.
- If the taxpayer is an individual and is at least 55 years of age at the time of the CGT event and the event happens in connection with their retirement (which would include a significant reduction in hours worked or a change in the nature of their present activities).
- If the taxpayer is a company or trust, the entity must have a significant individual (one who has a participation percentage in the company or trust of at least 20%) throughout the period of ownership and the significant individual was at least 55 years of age at the time of the CGT event. The significant individual does not need to be the same individual during the whole period.

Taxpayers under 55 years of age are not eligible for the 15-year exemption. However, they may be able to access the small business CGT 'retirement exemption' (see below), providing relevant conditions are met.

THE RETIREMENT EXEMPTION

A small business entity can choose that a capital gain arising from a CGT event be exempt if the proceeds are used in connection with retirement. A lifetime limit of $500,000 per individual applies on this exemption. If the individual is under 55 years of age at the time of the CGT event they may make a contribution equal to the amount of the capital gain on the disposal of the asset to a superannuation fund and no CGT will then be payable in their own name.

TIP: Often farmland has been transferred between generations within the one family. It is important to trace the history of the land to ensure that the current owner (and not just the wider family group) has held the land for 15 years before assuming the 15-year exemption can be accessed.

If the individual is 55 years of age or older they are not required to make the contribution to their superannuation fund but must indicate in their tax return for that year that they have applied the retirement exemption.

If the taxpayer is a company or trust they must satisfy the basic conditions of the small business entity concessions as well as the significant individual test. Other more specific requirements must also be met by a company or trust in order to access this concession, so care must be taken to ensure that all conditions are met.

THE BUSINESS ASSET ROLLOVER CONCESSION

The small business replacement asset rollover concession allows a taxpayer to defer any capital gain from a CGT event if the taxpayer subsequently acquires replacement assets. For example, a farmer could sell one farm and buy another farm down the road and choose to defer the capital gain on the disposal of the first farm by applying the gain on the sale of the original farm to the cost base of the new farm. The capital gain can be applied to a farm bought one year prior or two years after the sale of the first farm. Importantly however, both assets must be in the same name(s). On the subsequent sale of the new farm, the cost base of that farm is reduced by the rollover amount and tax is then payable on any capital gain at the time of the disposal of the subsequent asset. Figure 1 (page 3) illustrates a step-by-step process for determining applicability of CGT and CGT concessions.

Business structures and the application of CGT

The general discount on CGT applies to assets held for more than 12 months at the time of disposal. The relevant rates for each type of entity are listed in Table 1.

TABLE 1 Capital gains tax discount rates applicable to different entity types.

Entity type	General discount
Individual/sole trader	50%
Trusts	50%
Superannuation funds	33.3%
Company	0%

A partnership is not a taxable entity, it lodges a tax return each year, however, any gains or losses relating to CGT must be disclosed in the partner's own tax return and not that of the partnership. If the partner is an individual or a trust then the individual or trust may access the 50% general discount. However, if one of the partners is a company then no general discount applies to the company's share of the capital gain.

Impact of CGT on farm succession asset transfer

Many farm succession plans include provisions for the transfer of the farming land from one generation to the next. If land was acquired by the current owner prior to 19 September 1985 this land is not subject to CGT if disposed of or transferred by the current owner today. However, if that land is transferred, even if

FIGURE 1 Summary of process used to determine whether capital gain is to be included in your assessable income for the year.

Capital gains made during an income year

Keep the necessary CGT records

Step 1
Determine whether you satisfy the basic conditions for the small business CGT.

- No → You don't qualify for any of the small business CGT concessions. You may be eligible for the CGT discount.
- Yes ↓

Step 2
Determine whether you qualify for the small business 15-year exemption (not relevant to capital gains from depreciating assets).

- No → Step 3
- Yes ↓

Disregard the entire capital gain. You don't need to apply any of the other CGT concessions.

Step 3
Offset any capital losses against the capital gain.

Step 4
Determine if you are eligible for the CGT discount. If so, reduce the remaining capital gain.

Step 5
Determine if the capital gain is from a depreciating asset used at least partly for a non-taxable purpose. If so, you are not eligible for any other concessions and can't reduce your capital gain any further.

Step 6
Determine if you qualify for the small business 50% active asset reduction (if you answered 'Yes' at Step 1 you will qualify). If so, reduce the remaining capital gain. You can choose not to apply the 50% active asset reduction and go straight to the small business retirement exemption or rollover in Step 7.

Step 7
Determine if you qualify for the small business retirement exemption or rollover. If so, reduce the remaining capital gain.

Amount remaining equals the net capital gain to be included in your assessable income for the year.

SOURCE: WWW.ATO.GOV.AU

within the same family group, that transaction is now subject to CGT. For some farming families, maintaining that pre-CGT status on a valuable asset such as land is an important consideration and land transfers are often deferred and land dealt with in the landholder's Will instead. Land held within a discretionary trust is often easier to transfer between generations since control of a trust may be transferred through the appointment of new controllers of the trust while the assets within the trust are maintained as they were prior to the change. There are no CGT implications on the underlying assets of a trust in changes being made to the roles of trustee, appointor or guardian of the trust.

Managing CGT: what farm businesses need to do

Farming families need to consider CGT for both the assets they already own as well as any potential purchases.

1. Existing assets – land, shares, rental properties and other capital assets currently owned:
   a. Purchase documents should be retained permanently.
      - Signed Offer and Acceptance.
      - Settlement Statement.
      - Transfer of Land documents.
      - Share purchase information.

   b. Maintain an asset register for capital assets such as land and shares that includes:
      - name of legal owner(s) of the assets;
      - date of acquisition (note: this is the date of signing of a contract and not settlement date); and
      - cost of acquisition including stamp duty as well as any additional costs.

   c. Be familiar with any changes in ownership over the whole period of ownership of the asset that may have an impact on the cost base or starting date for CGT.

2. Potential purchases
   a. Consider the CGT consequences for any subsequent disposal of the asset.
      - Changes to legislation may impact on ultimate CGT liability at time of future sale but what would be the CGT consequences if the asset was sold in the next few years for each type of entity?

   b. Ensure correct legal name is used on all purchase documents to ensure ownership is in correct and intended name.
      - Include full name of all individuals if held in individual names.
      - Include full name of trustee as well as trust or super fund name if held by a trust or super fund.
      - Include full name of company including Australian Company Numbers (ACN) if held by a company.

Problems are often encountered when capital assets are sold and adequate purchase documents are not available to enable an accurate CGT calculation to be prepared. Certificates of Title for land rarely show the date when a contract was signed to acquire the land. The date on the title is the date that the transfer of land was registered and not the date the contract was signed. Scanned copies of original purchase documents are usually sufficient for CGT calculations and these should be kept by the owners of the asset, as well as in permanent records by advisers such as accountants.

CASE STUDY

David (57) and Leonie (53) are farmers. Due to a run of poor seasons they decide to sell the farm. Their turnover in the 2018 financial year was $900,000 and their net assets are $7 million. They purchased some farmland as joint tenants in October 1981 for $475,000. The land remains in their names up until it is sold in May 2018 for $1,200,000.

CGT implications?

- Exempt from CGT as this land was acquired before 19 September 1985.

FREQUENTLY ASKED QUESTIONS

Will the variable income of my business have an impact on whether I can access the small business concessions?

Yes. If you are contemplating a farm sale, with adequate planning it is sometimes possible to defer or bring forward income between tax years to ensure that in the year of sale of the farm that your business meets the small business $2 million turnover threshold. Look at timing of grain and livestock sales in the coming years and if you are selling your whole farm, consider the impact of a clearing sale on your turnover in that year.

If I inherit pre-CGT land from my father in his Will, does that retain its CGT status in my name?

No. Any pre-CGT assets held at the date of death are passed to you on the date of death at the market value on that day, and therefore, if subsequently sold or transferred, your capital gain is calculated by using the date of death market value as the cost base.

We farm with my parents, my brother and his wife, and our son. Does the maximum net asset test of $6 million only apply to my assets when I sell land held in my name or do I have to include the value of assets held by other family members?

You must consider the value of assets held by any entities 'connected' to you as well as any of your 'affiliates' and entities connected with your affiliates. Consequently, this may mean that if you are in partnership with all of your family members, and each of them holds some farmland in their own name and you hold some in your own name that you now decide to sell, the assets and land held by your 'partners' in the partnership will also be included. The net can be cast quite widely within this definition of connection and often precludes farmers from accessing the small business CGT concessions.

What rate of tax applies to capital gains?

Your net assessable capital gain is included in your tax return in the year of disposal of the asset (regardless of whether you've sold the asset for cash or on vendor terms) and is included along with your other income for that financial year. The capital gain and your other income combined in that year is then taxed at your marginal tax rate – depending on what tax bracket you are in. This presents another opportunity for good tax planning to ensure that you are not adding a taxable capital gain on top of high levels of ordinary income and ending up paying tax in the top tax bracket.

David and Leonie acquired the neighbour's farm in March 1998 and the purchase was in their names as joint tenants. The purchase price was $1,000,000, including stamp duty and associated costs. This land has also been in their names, until it was sold in May 2018 for $1,700,000, and has been farmed by David and Leonie through their family trust for the whole time they have owned it.

CGT implications?

- Active asset conditions have been met as the land has been used in their farm business.
- Net assets greater than $6 million, however, turnover of $900,000 (less than $2 million threshold).
- Capital gain

• Sale proceeds	$1,700,000
• Purchase price	$1,000,000
• Capital gain	$700,000
• Active asset discount	($350,000)
• Net capital gain	$350,000

Options:

- David's share of gain is $175,000
  - David can access the retirement exemption, and because he is over 55 he is not required to make contribution to his superannuation fund, but after this event will now have $325,000 of his $500,000 lifetime limit remaining.
- Leonie's share of gain is $175,000
  - Leonie can access the retirement exemption but because she is under 55 she is required to roll $175,000 into her superannuation fund within the required time.

Conclusion

CGT events are relatively infrequent for most farming operations, as a result accurate record-keeping is a very important factor in CGT management. It is important to check CGT implications in advance when sale or transfer of affected assets is being considered in order to understand the full impact after any concessions, exemptions or discounts have been applied.

ADDITIONAL RESOURCES

Australian Taxation Office:
https://www.ato.gov.au/General/Capital-gains-tax

MORE INFORMATION

Contact your accountant or financial adviser.

GRDC RESEARCH CODE

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