



Small business CGT concessions eligibility conditions

Basic eligibility conditions, order to apply, passively-held assets, active assets, affiliates, connection and control.

CGT concessions eligibility overview



How small business CGT concessions work, eligibility steps, order for applying concessions, effect on superannuation.

CGT Small business entity eligibility



Work out your aggregated turnover to see if you're a small business entity for the small business CGT concessions.

Small business affiliates



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Entities connected with you and control relationships



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Maximum net asset value test



The maximum net asset value test is a first step to qualifying for a small business CGT concession.

Active asset test



To be eligible for small business CGT concessions, your asset must pass the active asset test among other conditions.

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Extra eligibility conditions for the small business CGT concessions if the asset is a share or interest in a trust.

QC 72743

CGT concessions eligibility overview

How small business CGT concessions work, eligibility steps, order for applying concessions, effect on superannuation.

Last updated 6 June 2023

How the small business CGT concessions work, eligibility steps, order for applying concessions, effect on superannuation.

How the small business CGT concessions work

The small business CGT concessions allow you to reduce, disregard or defer some or all of a capital gain from an active asset used in a small business.

The 4 small business CGT concessions include the:

- small business 15-year exemption

- small business 50% active asset reduction
- small business retirement exemption
- small business roll-over.

The concessions are available when you dispose of an active asset and meet basic eligibility conditions.

You must then meet any additional conditions that apply specifically to the individual concessions.

There are rules about the [order you apply](#):

- the CGT small business concessions
- any current year or prior year capital losses
- the CGT discount.

You may be able to apply one or both of the following to each capital gain:

- more than one of the 4 concessions if you meet the conditions for each
- the CGT discount if it also applies.

Basic eligibility conditions

To be eligible for any of the CGT concessions, you must first meet the basic eligibility conditions.

Depreciating assets do not meet the basic eligibility conditions:

- Under the **uniform capital allowance system**, any gain or loss from a depreciating asset is included in your assessable income, or is deductible as a balancing adjustment, to the extent the asset was used for a taxable purpose (business use). The small business CGT concessions do not apply to gains you make on depreciating assets that are included in your income.
- You make a capital gain or capital loss from a depreciating asset to the extent you have used the asset for a non-taxable purpose (private use). Any capital gain you make in this way does not qualify for the small business CGT concessions because it reflects the non-business use of the asset.

All the concessions except for the small business 50% active asset reduction have additional requirements you must meet.

Step 1: Determine if you are an eligible entity

You must be one of the following:

- a CGT small business entity eligibility with an aggregated turnover of less than \$2 million
- not running a business (other than as a partner) but your asset is used in your affiliate or connected entity's small business (CGT concessions on passively-held assets)
- a partner in a partnership that is a small business entity, and the asset is either
 - an interest in a partnership asset (partnership assets)
 - an asset you own that is not an interest in a partnership asset (partner's assets) but is used in the business of the partnership
- you meet the maximum net asset value test.

Step 2: The asset must be an active asset

The asset must meet the active asset test.

Step 3: Is the asset a share in a company or an interest in a trust?

It must meet additional conditions.

Step 4: Does your situation involve a CGT event related to a partnership?

The eligibility condition in this step applies to a CGT event happening after 7:30 pm AEDT on 8 May 2018 that involves the creation, transfer, variation or ending of your right or interest to either:

- an amount of income or capital of a partnership
- an amount calculated by reference to the entitlement of a partner in a partnership to an amount of the partnership's income or capital.
- If the CGT event involved ending your right or interest, it must be a membership interest in the partnership immediately before the CGT event happens. For all other cases, your right or interest must be a membership interest in the partnership immediately after the CGT event happens.

Applying the small business CGT concessions

If you have more than one capital gain for the year, you can apply as many of the small business CGT concessions as you are eligible for until each capital gain is reduced to zero. Each active asset's attributable capital gain is assessed for CGT concession eligibility individually.

The small business 50% active asset reduction applies automatically if the basic conditions are met and you have not specifically chosen for it not to apply.

However, you must choose whether to apply the small business 15-year exemption, small business retirement exemption and small business roll-over.

You need to choose by the day you lodge your income tax return for the income year in which the relevant CGT event happened unless we allow you to make the choice later.

Lodging and preparing your income tax return is generally enough proof of the choice you've made. However, for the small business retirement exemption, you must keep a written record of the amount you choose to disregard.

Steps to apply the small business CGT concessions, capital losses and the CGT discount

Step 1: Do you meet the basic eligibility conditions for the small business CGT concessions?

- **Yes:** Go to step 2.
- **No:** You do not qualify for any of the small business CGT concessions. You may be eligible for the CGT discount.

Step 2: Do you qualify for the small business 15-year exemption?

- **Yes:** Disregard the entire capital gain. You do not need to apply any of the other small business CGT concessions.
- **No:** Go to step 3.

Step 3: Offset any capital losses against the capital gain

If you have more than one capital gain, you can choose the order in which your capital gains are reduced by your capital losses.

Step 4: If you are eligible for the CGT discount, reduce the remaining capital gain

Step 5: Apply the small business 50% active asset reduction to reduce the remaining capital gain

- You can choose not to apply the reduction and go straight to the small business retirement exemption or small business roll-over at step 6.

Step 6: If you qualify for the small business retirement exemption or small business roll-over, reduce the remaining capital gain

The amount remaining is the net capital gain to include in your assessable income for the year.

Example: applying the small business CGT concessions to reduce a capital gain

Kendra is a small business operator who sells an active asset that she has owned for more than 12 months. She makes a capital gain of \$20,000.

Kendra also has a separate capital loss of \$4,000.

She meets all the conditions for the small business 50% active asset reduction and the CGT discount.

Kendra calculates her net capital gain as follows:

\$20,000 (capital gain)
– \$4,000 (capital loss)
= \$16,000 (net capital gain)
× 50% (applying the CGT discount)
= \$8,000 (net capital gain)
× 50% (applying the small business active asset reduction)
= **\$4,000** (reduced capital gain)

Kendra may be able to further reduce her \$4,000 (already reduced) capital gain by using the small business retirement

exemption and small business roll-over if she meets the conditions for those concessions.

If eligible, she can keep applying the other small business CGT concessions to reduce her capital gain to zero.

How the CGT concessions affect super contributions

Small business 15-year exemption

You may be able to contribute amounts to your super fund from the small business 15-year exemption without affecting your non-concessional contributions limits.

Small business retirement exemption

You may be able to use amounts from the small business retirement exemption as contributions to your super fund without affecting your non-concessional contributions limits.

CGT concessions on passively-held assets



Details of the conditions you must meet to claim CGT concessions on passively-held assets.

QC 22655

CGT concessions on passively-held assets

Details of the conditions you must meet to claim CGT concessions on passively-held assets.

Last updated 6 June 2023

To claim CGT concessions on passively-held assets, you must meet the following conditions:

- Your affiliate or entity connected with you is a small business entity for the same income year that the CGT event happens to your CGT asset.
- In the income year that the CGT event happens to your asset, the same affiliate or entity connected with you must
 - be using the asset in their business
 - be a small business entity, and
 - the asset must meet the active asset test for the same time.
- You don't run a business in the income year other than in a partnership. If you run a business in a partnership, the CGT asset cannot be your interest in a partnership asset.

In determining whether the entity that uses the passively-held asset is a **small business entity**, there's a special rule for calculating aggregated turnover. To calculate the aggregated turnover of the small business entity, you must include the turnover of your affiliates or entities connected with you. **Calculating aggregated turnover** is otherwise the same.

An entity that is your **affiliate** or **connected with you**, is deemed to be an affiliate of, or connected with the small business entity that uses the asset. There is a **special affiliate rule** for spouses and children under 18.

Example: passively-held asset eligible for CGT concessions

Palik owns land that she leases to a company she wholly owns, Fossy Farm Pty Ltd. Fossy Farm Pty Ltd uses the land in its farming business.

The aggregated turnover of Fossy Farm Pty Ltd is \$1.8 million.

Palik does not run a business herself.

Palik can access the small business CGT concessions in relation to the disposal of the land because:

- Palik does not run a business
- Fossy Farm Pty Ltd, as a connected entity that uses the land to run their business, has an aggregated turnover less than \$2 million.

Superannuation funds cannot claim CGT concessions

The small business CGT concessions are not available for any capital gain a superannuation fund makes on the sale of an asset used in a related entity's business.

For example, a super fund may own premises used in the business of a related entity. However, as the members or trustees of the fund (who typically also control the related entity) don't control the fund as required, the related entity is not a connected entity. Therefore, the business property is not an active asset.

QC 52268

CGT small business entity eligibility

Work out your aggregated turnover to see if you're a small business entity for the small business CGT concessions.

Last updated 6 June 2023

Small business entity eligibility for the CGT concessions

You're a CGT small business entity for the 4 CGT concessions if you're an individual, partnership, company or trust that:

- is running a business
- has an aggregated turnover of less than \$2 million.

Aggregated turnover is your annual turnover plus the annual turnovers of any business entities that are your **affiliates** or **connected with you**.

If your business is a partnership, it's the partnership and not the individual partner that must be the CGT small business entity.

To work out whether you're a CGT small business entity for the current year, you need to [calculate your aggregated turnover](#).

You're a CGT small business entity for the current year if your:

- aggregated turnover for the previous income year was less than \$2 million
- actual aggregated turnover is less than \$2 million at the end of the income year.

You need to work out if you are eligible each year.

Calculate your aggregated turnover

To calculate your aggregated turnover, you need to:

1. [work out your annual turnover \(for your previous or current year\)](#)
2. [include the annual turnover of any affiliates or connected entities](#)
3. [work out your aggregated turnover](#).

If you do not have any affiliates or entities connected with you, your aggregated turnover is the same as your annual turnover. In this case, you only need to do step 1.

Step 1: Work out your annual turnover (for your previous or current year)

Your annual turnover includes all **ordinary income** you earned in the normal course of running a business for the income year. Annual turnover is your gross income or proceeds, not your net profit.

You can:

- use your previous year's annual turnover
- use your actual annual turnover at the end of the current year
- estimate your current year annual turnover.

You can only estimate your current year annual turnover if your annual turnover for 1 of the 2 previous income years was less than \$2 million.

You need to determine whether your annual turnover is likely to be less than \$2 million.

You must estimate your annual turnover based on the conditions that you're aware of at the beginning of the income year.

Factors to consider when estimating your annual turnover include:

- your annual turnover in previous income years
- whether you plan to reduce or increase staff in the current year
- whether your business operating hours are increasing or decreasing
- whether previous extraordinary sales or product lines will be available in the current income year
- whether your business will face increased competition in the current income year
- whether your business activity will increase or decrease because of changing conditions.

If you operate multiple business activities, either as a sole trader or within the same business structure, you must include the income from all your activities when working out your annual turnover. For example, a sole trader operating a part-time consultancy and a retail shop would include the income from both business activities when working out annual turnover.

Include these amounts in your annual turnover:

- sales of trading stock
- fees for services provided
- interest from business bank accounts
- **foreign business income**
- amounts received to replace something that would have had the character of business income - for example, a payment received for the loss of business earnings.

Do not include these amounts:

- GST you charged on a transaction

- amounts borrowed for the business
- proceeds from the sale of business capital assets
- insurance proceeds for the loss or destruction of a business asset
- amounts received from repayments of farm management deposits
- retail fuel sales. This is a special rule because sales of retail fuel are usually high in sales volume with low profit margins.

Assessable income from an individual's personal income protection insurance policy is not included as it is not from a business activity.

Operating a business for part of the year

If you start or cease a business part way through an income year, you must make a reasonable estimate of what your annual turnover would have been if you ran the business for the entire income year.

Non-arm's length business transactions

If you have business transactions with associates that are not at arm's length (that is, you discounted the goods or services you sold to them because of their association with you), you must use the market value of the goods or services when calculating your annual turnover.

However, you may consider any discounts that you would have offered typically, had the dealing been at arm's length.

As an individual, your associates include, but are not limited, to:

- your relatives, such as your spouse or children
- a partnership that you are a partner in
- another partner in that partnership, and that partner's spouse and children
- a trustee of a trust that you, or your associate, are a beneficiary of
- a company that you, or your associate, control or influence.

There are similar rules to determine who is an associate of a company, partnership and trustee. For a full list of what is considered an associate, see *Income Tax Assessment Act 1936 Section 318*.

Example: non-arm's length business transaction

Lana runs a printing business and Max runs a florist business. Lana and Max are married and are therefore each other's associate.

Lana manufactures 200 gift cards for Max which he uses in his florist business. Lana only charges him the amount it costs her to manufacture the gift cards, with no profit margin.

This is a non-arm's length transaction between associates so the amount that Lana must include in her annual turnover is the ordinary income she would have made from the sale of the gift cards if the transaction had been at arm's length.

A useful guide for the amount she must use is the price she would charge any regular customer (considering bulk discounts that she would offer other customers).

Step 2: Include the annual turnover of any affiliates or connected entities

Include the annual turnover of any relevant business entity that, at any time during the income year, was:

- your affiliate
- connected with you.

Repeat [step 1](#) for each relevant business entity to work out their annual turnover.

You must use the same method for working out your annual turnover and the annual turnovers of all your relevant businesses entities.

Special rules for partnerships

There's a special rule for calculating the aggregated turnover of a partnership in cases where a partner's asset is being used in the business run by the partnership.

An entity that is your affiliate, or connected with you, is deemed to be an affiliate of, or connected with the partnership that uses the asset.

In calculating the aggregated turnover of the partnership, the turnover of entities that are deemed to be affiliates or connected entities must be included. The calculation of aggregated turnover is otherwise the same.

There's another special rule for working out aggregated turnover where:

- you are a partner in more than one partnership, and
- the asset is used in more than one partnership's business.

In this case, each partnership that you're a partner in, and that uses the asset, is treated as being connected with the partnership for the purpose of working out whether it's a small business entity (the test entity).

When working out the aggregated turnover of the test partnership, the turnover of any other partnerships that are deemed to be connected must be included.

Step 3: Work out your aggregated turnover

Add the annual turnovers of relevant business entities to your annual turnover. This is your aggregated turnover.

Do not include income:

- from dealings between you and a relevant business entity
- from dealings between any of your relevant business entities
- of an entity when it was not your relevant business.

'Dealings' are transactions or relations with others, usually in business.

If your aggregated turnover is less than \$2 million, you're a small business entity for the current year.

If you're not a small business entity in an income year, you may still be able to access the CGT concessions if you meet the **maximum net asset value test**.

Example: working out aggregated turnover

Jigna has an affiliate, Tom, who owns a company, Tomico.

When Jigna is working out her aggregated turnover, she includes:

- Tom's turnover because Tom is Jigna's affiliate
- Tomico's turnover because she is connected to the company through her affiliate.

Jigna does not include any income from her transactions with Tom or Tomico.

QC 52267

Small business affiliates

How to include affiliates for small business CGT concessions.

Last updated 6 June 2023

What is an affiliate?

A small business affiliate is any individual or company that, in relation to their business affairs, acts or could reasonably be expected to act either:

- according to your directions or wishes
- in concert with you.

Trusts, partnerships and superannuation funds cannot be your affiliates. However, a trust, partnership or super fund may have an affiliate who is an individual or company.

When working out your eligibility for small business capital gains tax (CGT) concessions, you'll need to consider if additional entities may be your affiliates.

If these additional entities are considered your affiliate, this will affect the:

- calculation of your aggregated turnover
- calculation of the maximum net asset value test
- the application of the active asset test.

What it means to be acting in accordance or in concert

Whether a person acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, depends on the circumstances of the case. Relevant factors include:

- the existence of a close family relationship between the parties
- the lack of any formal agreement or formal relationship between the parties setting out how the parties are to act in relation to each other
- the likelihood that the way the parties act, or could reasonably be expected to act, in relation to each other would be based on the relationship between the parties rather than on formal agreements or legal or fiduciary obligations
- the actions of the parties.

Example: married couple acting in accordance as affiliates

Bernard and Saskia are married. Bernard has an events management business with an annual turnover of \$1.7 million, and Saskia owns a consultancy business with an annual turnover of \$1.8 million.

Both Bernard and Saskia act in accordance with each other's wishes because each values the relevant expertise the other can provide. Therefore, they are both small business affiliates because they are acting in accordance with directions in relation to their business.

Bernard and Saskia will need to count each other's business turnover when working out their businesses' aggregated turnover.

A person is not your small business affiliate just because of the business relationship you share. For example, if you're a partner in a partnership, another partner is not your affiliate merely because they act, or could reasonably be expected to act, in accordance with your directions in relation to the affairs of the partnership.

Similarly, companies and trusts are not affiliates of their directors and trustees respectively, and vice versa, just because of the positions held.

Generally, another business would not be acting in accordance with you if they:

- have different employees
- have different business premises
- have separate bank accounts
- do not consult with you on business matters
- conduct all their business affairs independently.

When your spouse and children are affiliates

Your spouse or child is not automatically your small business affiliate. You must consider whether they are acting according to your directions or wishes, or in concert with you, in relation to their business affairs.

Example: married couple who are not small business affiliates

Matt and Sandy are married. Matt owns a cleaning business with an annual turnover of \$1.9 million, and Sandy has a bakery with an annual turnover of \$1.5 million.

They are not connected with each other's businesses. They have:

- separate bank accounts for their businesses
- different business locations
- their own employees.

Neither Matt nor Sandy controls the management of the other's business.

Even though Matt and Sandy are married, neither is an affiliate of the other because they:

- do not act in concert with each other in respect to their businesses
- do not act according to the directions or wishes of their spouse.

As a result, neither Matt nor Sandy needs to include the annual turnover of the other's business in calculating the aggregated turnover of their own business.

Special affiliate rule

There is a special affiliate rule for spouses and children under 18 years old. This is when you own an asset that your spouse or child uses in a business they run as an individual, they are considered to be your small business affiliate for the purposes of the:

- active asset test
- maximum net asset value test
- \$2 million aggregated turnover threshold for CGT concessions.

Your spouse or child may be considered your affiliate when an asset is owned by:

- you and that asset is used in a business run by an entity that your spouse (or child) owns or has an interest in
- an entity that you own or have an interest in, and that asset is used in a business run by your spouse (or child), or an entity that your spouse or child has an interest in.

Your spouse or child is treated as your affiliate when working out whether the entity that owns the asset is an affiliate of, or **connected with**, the entity that uses the asset in their business.

If treating your spouse or child as your affiliate, the business entity is considered to be an affiliate of, or **connected with**, the entity that owns the asset, then the special affiliate rule will also apply to treat the spouse or child as an affiliate of the individual for the purposes of the small business CGT concessions. This relates to:

- the basic eligibility for the small business CGT concessions
- calculating aggregated turnover and maximum net asset value.

If this second stage of the special affiliate rule applies, it will also apply for any gain that arises from any asset that either the asset owner or the business entity, or the individual or their spouse or child, owns. This affiliate rule works both ways, so that the individual is also considered to be an affiliate of their spouse or child. However, it only applies for as long as both are true:

- the person is their spouse, or the child is under 18 years old
- any asset is passively held.

This affiliate rule for spouses and children should also be considered when working out if you have an **active asset** for CGT purposes.


This affiliate rule applies only if the business entity is not already an affiliate of, or connected with, the asset owner.

Example: spouse affiliates with passively-held assets

Philip owns 100% of Horse Farm Pty Ltd, which owns land. Horse Farm Pty Ltd does not run a business.

However, Philip's spouse, Crystal, owns Pig Farm Pty Ltd, which uses Horse Farm Pty Ltd's land to run a business.

Philip also owns 30% of another entity, Carrot Pty Ltd. Crystal owns 70% of Carrot Pty Ltd.

Diagram showing the relationship between Philip, Crystal and their companies, Horse Farm Pty Ltd, Pig Farm Pty Ltd and Carrot Pty Ltd. Philip owns 100% of Horse Farm Pty Ltd, which owns land. Horse Farm Pty Ltd does not run a business. However, Philip's spouse, Crystal, owns Pig Farm Pty Ltd, which uses Horse Farm's land to run a business. Philip also owns 30% of another entity, Carrot Pty Ltd. Crystal owns 70% of Carrot Pty Ltd.

Applying the affiliate rule

In determining whether Pig Farm Pty Ltd (the entity that uses the land in its business) is connected with Horse Farm Pty Ltd (the entity that owns the land), we need to apply the affiliate rule. Crystal, as Philip's spouse, is considered to be Philip's affiliate because an asset owned by Philip's entity (Horse Farm Pty Ltd) is used in Crystal's business (Pig Farm Pty Ltd).

Pig Farm Pty Ltd is connected with Horse Farm Pty Ltd because Philip:

- controls Horse Farm Pty Ltd, and
- together with his affiliate, Crystal, controls Pig Farm Pty Ltd.

This makes the land that Horse Farm Pty Ltd owns an active asset because it is used in the business of Pig Farm Pty Ltd which is controlled by the same third entity, Philip.

Affiliates, connected entities and small business CGT concessions access

Because Crystal is treated as Philip's affiliate in determining whether Pig Farm Pty Ltd is an affiliate of, or connected with, Horse Farm Pty Ltd, Crystal is also treated as Philip's affiliate for testing whether Carrot Pty Ltd is connected with Horse Farm Pty Ltd.

Carrot Pty Ltd is connected with Horse Farm Pty Ltd because Philip:

- controls Horse Farm Pty Ltd, and
- together with his affiliate, Crystal, controls Carrot Pty Ltd.

Horse Farm Pty Ltd needs to include the net assets of its affiliates and entities connected with it (Pig Farm Pty Ltd and Carrot Pty Ltd) when seeking access to the small business CGT concessions through the maximum net asset value test. Horse Farm Pty Ltd must not be running a business to qualify under this condition.

Horse Farm Pty Ltd can access the small business CGT concessions if:

- its maximum net asset value is not more than \$6 million
- Pig Farm Pty Ltd's aggregated turnover is less than \$2 million.

Pig Farm Pty Ltd wants to seek access to the small business CGT concessions through the small business entity aggregated turnover test. Pig Farm Pty Ltd's aggregated turnover would include the annual turnovers of its affiliates and entities connected with it. This includes Carrot Pty Ltd if it runs a business and has turnover.

Franchisee and franchisor affiliation

Franchisees are not necessarily small business affiliates of the franchisor simply because of the franchise relationship.

Whether the franchisee acts in concert with the franchisor about their franchise business depends on, among other things, the nature of the franchise agreement between them.

The affiliate relationship does not extend to the relationship between the controller of an entity and the entity itself – for example, a director and the company. The relationship in these situations is decided more by obligations imposed by law, formal agreements and fiduciary obligations.

Therefore, companies, trusts and partnerships are not considered to be affiliates (and vice versa) of the various officers, persons and entities that are related to the company, trust or partnership in various capacities – for example, the trustees and beneficiaries of a trust, the directors and shareholders of a company, or the partners in a partnership.

QC 50236

Entities connected with you and control relationships

Identify if you're connected with another entity by determining if you have a relevant control relationship with it.

Last updated 9 September 2025

Control determines entities connected with you

An entity may be connected with you if you have a control relationship with it. This is important to know when working out your aggregated turnover for small business concessions. You may have a control relationship with another entity if:

- you control it
- you are controlled by it
- you and the entity are controlled by another entity
- it's controlled by your affiliate
- it's controlled by you and your affiliate together
- it is controlled by an entity that you control (see the [indirect control test](#)).

Control of a company

You control a company if you and/or your affiliates have shares and other interests in the company (or the right to acquire them) that together give you a right to:

- exercise or control 40% or more of the voting power in the company

40% or more of any distribution of income (for example, dividends) or capital of the company.

Example: working out control of a company

Lucy is a sole trader. Her interests in Cool Computers give her the right to exercise 30% of the voting power in the company.

Sean is Lucy's affiliate. He owns other interests in Cool Computers that give him the right to exercise 30% of the voting power in that company.

Lucy controls Cool Computers because Lucy and Sean's interests together allow them to exercise 60% of the voting power of the company. This gives her a control percentage of 60%.

Lucy must include Cool Computers' and Sean's annual turnovers (as he is an affiliate) when working out her aggregated turnover.

Control of a partnership

You control a partnership if you and your affiliates own, or have the right to acquire, interests in the partnership that give you both together a right to 40% or more of the partnership's net income (for tax purposes), distribution of income or capital of the partnership.

Control of trusts

The control rules for trusts depends on the type of trust.

Control of a trust (other than a discretionary trust)

You control a trust (other than a discretionary trust) if you and your affiliates together own, or have the right to acquire, interests in the trust that give you the right to 40% or more of any distribution of income, net income or capital by the trust.

Control of a discretionary trust

There are 2 tests to determine if you control a discretionary trust, the:

- [distribution test](#)
- [influence over trustee test.](#)

If you meet either of these tests, you control a discretionary trust.

Distribution test

You meet the distribution test if:

- in **any** of the previous 4 income years, you and your affiliates together were paid, or had applied for you or your affiliate's benefit, 40% or more of either:
 - the income of the trust applied or paid in that year
 - the capital of the trust applied or paid in that year
- you're not a tax-exempt entity or deductible gift recipient.

Your control percentage is the highest of the percentage of the income or capital of the trust paid to, or applied for you, or your affiliates benefit in the prior 4 years.

Example: working out control of a trust

Gavin is working out whether he is an eligible small business entity for the current income year. He's received distributions from a family discretionary trust that carries on a business. Gavin needs to work out whether he needs to include its annual turnover in his aggregated turnover calculation.

Gavin must look at the trust distributions received by himself (and any of his affiliates) up to 4 years before the current year, to determine if he controls it in the current income year.

Gavin received a distribution from the family trust 3 years ago which was 70% of the total amount of the income the trust distributed in the same income year.

Gavin controls the family trust in the current income year because he received a distribution of income 3 years ago, that was more than 40% of the total amount of income distributed by the trust in that income year. His control percentage is 70%

When working out his aggregated turnover to determine if he is a small business entity for the current income year, Gavin includes the annual turnover of the family trust.

Influence over trustee test

You meet this test if the trustee either acts, or might reasonably be expected to act, in accordance with you or your affiliates directions or wishes, or the wishes of you and your affiliates acting together.

You must consider all the relevant circumstances to work out whether you and your affiliates together, or alone satisfy this test, including:

- the trust deed
- the manner in which the trustee has acted in the past, including how it has responded to any directions, instruction or wishes you or your affiliates have given it, whether directly or indirectly
- the nature of the relationships between you, your affiliates and the trustee, for example if the trustee is a natural person are they related to you; if an entity, do you control that entity, or is the trustee completely independent
- the amount of property or services you or your affiliates (or both) transferred or provided to the trust

- any arrangement or understanding between you and any person who has benefited under the trust in the past who may have influence over the trustee.

Trustee did not make a distribution

For the purposes of the small business CGT concessions, the trustee of a discretionary trust can also nominate up to 4 beneficiaries as controllers of the trust for an income year if:

- the trustee did not make a distribution of income or capital, and
- the trust had a tax loss or no taxable income.

The trustee may wish to make the nomination to ensure that a particular CGT asset is treated as an active asset for that income year. The nomination must be in writing and signed by the trustee and each nominated beneficiary.

A nominated beneficiary is connected with the trust (and the trust is connected with the nominated beneficiary) for the purposes of the small business CGT concessions:

- maximum net asset value test
- the aggregated turnover test
- active asset test.

Commissioner's discretion if you control an entity, but your control percentage is less than 50%

If you control an entity under one of the control tests because you have a control percentage of 40% or more, the Commissioner may determine that you don't control an entity if:

- your control percentage in the entity is less than 50%
- the Commissioner thinks that another entity or group of entities, not including your affiliates, actually controls the entity.

The discretion is not available if you control a discretionary trust, because you pass the influence over trustee test.

In considering whether another entity (or group of entities) actually controls the entity, the Commissioner will have regard to the facts and circumstances of each case.

The nature of control relevant for the Commissioner's discretion, is control over matters typically associated with ownership of a business entity. Such as:

- entitlements to income and capital of the entity
- participation in decision-making on key matters affecting the entity's constitution, funding, structure and management-this includes matters such as:
 - decision-making on the composition and oversight of the management team
 - amending the entity's constituent documents
 - deciding on capital and entity restructuring proposals, the issue of new ownership interests or winding up
 - authorising significant changes in the direction of the entity's business operations.

Whether or not another entity (or group of entities) has a control percentage of at least 40% may assist in determining whether it actually controls the entity, but it's not decisive.

Sole or primary responsibility for the day-to-day management of the affairs of the entity, while not irrelevant to the question of who controls that entity, doesn't constitute control for the purposes of the discretion.

Example: discretion about the control test

Lachlan owns 45% of the shares in a private company. He plays no part in the day-to-day or strategic decision making of the company.

Daniel owns 45% of the shares in the company. He is not an affiliate of Lachlan.

The shareholder of the remaining shares (10%) doesn't take part in the management of the business and is not an affiliate of either Lachlan or Daniel.

All shares carry the same income, capital and voting rights. Daniel makes all day-to-day and strategic decisions for the company.

Even though Lachlan owns 45% of the shares in the company, he is not taken to control the company if the Commissioner of Taxation is satisfied that the company is actually controlled by Daniel and/or the 10% shareholder. In considering if Daniel and the 10% shareholder has actual control of the private company, the Commissioner would consider all the facts and circumstances, including:

- whether there is an agreement which affects the voting decisions of the 10% shareholder and the terms of such an agreement
- the terms of any governing documents or other formal arrangements which affect the shareholders' ability to decide or influence matters that are associated with the ownership of the company; and
- the circumstances in which Daniel came to be making the strategic decisions for the company.

For more information, see TD 2023/5: Income tax: aggregated turnover and connected entities - Commissioner's discretion that an entity does not 'control' another entity.

Indirect control test

Under the indirect control test, you control an entity that is controlled directly or indirectly, by another entity you control. This test is designed to determine control of structures that include interposed entities. For example, where you directly control a second entity, and the second entity either directly or indirectly controls a third entity, you are considered to also control the third entity.

In the following figure, the business entity:

- controls Company A as it owns more than 40% of Company A's ordinary shares.
- Company A controls Company B as it owns more than 40% of Company B's ordinary shares.
- Company B doesn't control Company C as it owns less than 40% of Company C's ordinary shares.

- neither Company A nor the business entity controls Company C because Company B owns less than 40% of Company C's ordinary shares.

So the business entity controls companies A and B, but not company C.

Diagram illustrating a shareholding hierarchy: A top-level business entity owns 50 percent of ordinary shares in Company A. Company A owns 50 percent of ordinary shares in Company B. Company B owns 30 percent of ordinary shares in Company C. The structure flows vertically from the business entity at the top to Company C at the bottom.

Public entity exception

The indirect control test doesn't apply to cause you to control entities controlled by a public entity you control. However, you may still control these entities if you, or your affiliates together, have ownership interests, or rights to acquire ownership interests in these entities that cause you to meet one of the primary control tests.

A public entity means:

- a company whose shares are listed for quotation in the official list of an approved stock exchange, unless those shares have the right to a fixed dividend rate
- a publicly traded unit trusts
- a mutual insurance companies
- a mutual affiliate companies
- any company, in which all the shares are beneficially owned by one or more of any of the entities previously listed.

QC 50239

Maximum net asset value test

The maximum net asset value test is a first step to qualifying for a small business CGT concession.

Last updated 6 May 2024

Calculate net value of CGT assets

The maximum net asset value test is one of the tests which can be used to see if you meet **step one of the small business CGT concessions** as an eligible entity.

To meet the test, the total net value of CGT assets owned by you, entities connected with you, affiliates and entities connected with your affiliates, must not exceed \$6 million. You must meet the test just before the CGT event that results in the capital gain.

The net value of the CGT assets of an entity is the sum of the market values of those assets less any liabilities of the entity that are related to those assets and provisions made for:

- annual leave
- long service leave
- unearned income
- tax liabilities.

The net value can be positive, negative or zero. The \$6 million limit is not indexed for inflation.

To calculate the net value of your CGT assets, you must add together the net value of assets owned by:

- you
- any entities connected with you
- any of your affiliates and entities connected with your **affiliates**
 - but only if the assets are used, or held ready for use, in a business run by you or an entity connected with you
 - don't include an asset if it is used in the business of an entity that is connected with you only because of your affiliate.

Entities that hold shares or trust interests would calculate their net asset value in a similar way.

Example: CGT assets to include to calculate total net value

Colin operates a newsagency as a sole trader.

Colin's son, Simon, runs his own florist business, which is unrelated to the newsagency business. Simon owns the land and building where the newsagency is conducted and leases it to Colin.

Simon also owns 100% of the shares in Simco Pty Ltd, which runs a separate business. Simon is connected with Simco Pty Ltd because he controls the company. Simon regularly consults Colin for advice in his business affairs and acts according to Colin's wishes, which makes Simon Colin's affiliate.

To determine whether Colin satisfies the maximum net asset value test, he includes the market value of the land and building owned by Simon (because it is used in his newsagency business). He does not include:

- Simon's other assets used in his florist business (because they're not used in the newsagency business)
- Simco Pty Ltd's assets (because those assets are not used in his business and Simco Pty Ltd is only connected because of his affiliate, Simon).

If you're a partner in a partnership

If you're a partner in a partnership and the CGT event happens to an asset of yours or a CGT asset of the partnership (for example, disposal of a partnership asset), the maximum net asset value test would include:

- if you're connected with the partnership – all the assets of the partnership (excluding the value of your interest in the partnership)
- if you're **not** connected with the partnership – only your interest in the partnership (exclude the assets of the partnership as a whole).

Entities that hold shares or trust interests would calculate their net asset value in a similar way.

Assets to include

Assets to include in calculating the net value of the CGT assets are not restricted to business assets. They include all CGT assets of the entity unless the assets are specifically [excluded](#).

Although gains from **depreciating assets** may be treated as income rather than capital gains, depreciating assets are still CGT assets and are included when calculating the net asset value.

Where a dwelling is an individual's main residence, the individual should consider how much of the dwelling was used to produce assessable income that either:

- gives rise to deductions for interest payments
- would give rise to deductions for interest if interest had been paid.

The individual would be entitled to deduct part of the interest on money they borrowed to buy the home if:

- part of the home is set aside exclusively as a place of business and is clearly identifiable as such, and
- that part of the home is not readily adaptable for private use – for example, a doctor's surgery in a doctor's home.

This is a hypothetical interest deductibility test. If the individual didn't incur any interest, the test looks at whether they would have been entitled to a deduction had they taken out a loan to purchase their home.

If the dwelling has been used to earn income, the percentage of income-producing use is multiplied by the current market value to work out the value of the dwelling that should be included in calculating the net value of the CGT assets. This calculation considers the percentage of floor area and the length of time the dwelling was used to produce assessable income.

Example: Calculating the value of a main residence to be included in the net value of CGT assets

Ben's main residence has a market value of \$750,000 just before applying the maximum net asset value test. Ben has owned the

dwelling for 12 years:

- for the first 3 years, 20% of it was used to earn assessable income
- for the following 2 years, 40% was used to earn assessable income
- for 2 years, it was used solely as a main residence
- for the last 5 years, 10% was used to earn assessable income.

Ben's main residence has had 15.8% income-producing use, calculated as follows:

- $3 \div 12 \text{ years} \times 20\% = 5.0\%$
- $2 \div 12 \text{ years} \times 40\% = 6.7\%$
- $2 \div 12 \text{ years} \times 0\% = 0.0\%$
- $5 \div 12 \text{ years} \times 10\% = 4.1\%$

\$118,500 is the business use of the main residence's market value ($\$750,000 \times 15.8\%$).

Ben has a liability of \$500,000 attached to the dwelling. Therefore, 15.8% (\$79,000) of the liability is included in the calculation to reduce market value of the business use portion of the main residence.

Ben will use \$39,500 ($\$118,500 - \$79,000$) as the value of his main residence to be included in calculating the net value of his CGT assets.

Liabilities and provisions to include

Some liabilities to include in determining the net value of CGT assets are:

- legally enforceable debts due for payment
- existing legal or equitable obligations to pay either a certain sum or ascertainable sums.

Some of the amounts are not liabilities for the purpose of calculating the net value of CGT assets, such as:

- provisions for possible obligations to pay damages in a pending lawsuit
- provisions for liabilities in respect of an earn-out contract
- provisions for the guarantee of a loan
- provisions for long service and annual leave entitlements
- provisions for income and other taxes prior to liability arising
- accounting liabilities arising as a result of receiving prepaid income
- provisions in general, for such things as quantity rebate.

Despite provisions for annual leave, long service leave, unearned income and tax liabilities not falling within the meaning of the term 'liabilities', they are specifically included in calculating the net value of CGT assets.

Liabilities related to assets

A liability must be related to the CGT assets of an entity to be considered in determining the net value of the CGT assets of the entity.

This includes liabilities directly related to assets that are included in the calculation – for example, a loan to finance the purchase of business premises.

It also includes liabilities not directly related to a particular asset but to the assets of the entity more generally – for example, a bank overdraft or other short-term financing facility that provides working capital for the operation of the business.

However, liabilities that are directly related to an asset that is excluded from the net asset calculation can't be included – but [certain liabilities related to excluded interests in connected entities may be counted](#).

For further information about liabilities to include and liabilities related to assets, see Taxation Determination **TD 2007/14** *Income tax: capital gains: small business concessions: what 'liabilities' are included in the calculation of the 'net value of the CGT assets' of an entity in the context of subsection 152-20(1) of the Income Tax Assessment Act 1997?*

Example: assets and liabilities to include for a company

Cool Tool Pty Ltd is selling its business. The assets and liabilities of the company are as follows:

Assets:	Amount:
Plant and machinery	\$1,500,000
Freehold premises	\$3,500,000
Total assets	\$5,000,000
Liabilities:	Amount:
Mortgage (secured over the premises)	\$2,000,000
Provision for leave of employees	\$500,000
Provision for rebates	\$200,000
Provision for possible damages payout	\$100,000
Total liabilities	\$2,800,000
Net assets	\$2,200,000

The net value of the CGT assets of the company is calculated as follows:

Assets:	Amount:
Plant and machinery	\$1,500,000
Freehold premises	\$3,500,000
Total assets	\$5,000,000
Liabilities:	Amount:

Mortgage (secured over the premises)	\$2,000,000
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Provision for leave of employees	\$500,000
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Total liabilities	\$2,500,000
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Net value of CGT assets	\$2,500,000
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The following items are not considered in working out the net value of the CGT assets of Cool Tool Pty Ltd because they are not within the meaning of the term 'liabilities':

- provision for possible damages payout
- provision for rebates.

Assets to exclude

Certain interests in connected entities

When calculating net value, you should exclude the shares, units and other interests (apart from debt) that you hold in an entity connected with you or your affiliate.

This is because the net value of the CGT assets of the connected entity is already included in the test.

However, include any liabilities relating to these excluded interests in connected entities.

Non-business assets of affiliates or entities connected with affiliates

Don't include an asset of your affiliate or an entity connected with your affiliate if it is used, or held ready for use, in the business of an entity that is connected with you only because of your affiliate.

Personal use and superannuation assets

If you're an individual, you should disregard the following assets when working out the net value of your CGT assets:

- assets used solely for your personal use and enjoyment, or that of your affiliate

- your own home, to the extent that you use it for private purposes (also, if your only other use is some incidental income-producing use, exclude your home from the net asset value test). If you've used part of your home to produce assessable income, you must make a [reasonable apportionment](#)
- rights to amounts payable out of a super fund or approved deposit fund
- rights to an asset of a super fund or approved deposit fund
- insurance policies on your life.

A requirement for an asset to be used 'solely for your personal use and enjoyment' means that any income producing use of an asset, no matter how trivial, will disqualify it from being disregarded when calculating the net value of your CGT assets.

For example, an interest earning personal bank account is not an asset used 'solely for your personal use and enjoyment', even where its funds are used for personal expenses. This is because interest accrued on the principal amount of cash at bank is a form of income. As such, you will have to include the amount of cash at bank when calculating net value of your CGT assets.

When an asset is excluded, any related liability is also disregarded because these liabilities are not related to an asset included in the net asset value calculation.

Example: personal use assets excluded from calculating the net value of the CGT assets

Lana is a sole trader. The market value of Lana's CGT assets is:

Assets	Amount
Land used in business	\$50,000
Business goodwill	\$200,000
Business bank account	\$50,000
Trading stock	\$100,000

Trade debtors	\$30,000
Plant	\$50,000
Boat (used solely for personal use)	\$50,000
Home	\$600,000
Personal bank account (interest earning)	\$20,000
Total	\$ 1,150,000

Lana borrowed \$20,000 to buy the boat.

When working out the net value of her CGT assets, Lana doesn't include:

- the market value of her boat as it a personal use asset
- the liability for the boat as it is directly related to a personal use asset.

Lana uses 50% of her home exclusively for income-producing activity. She includes 50% of the value of her home, representing the income-producing percentage, and doesn't include the other 50% (\$300,000).

Lana needs to include the balance of her personal bank account in the calculation of the net asset value as the bank account is an income producing CGT asset.

Therefore, the net value of her CGT assets is:

$$\$1,150,000 - \$350,000 = \mathbf{\$800,000}$$

Lana has met the maximum net asset value test as a first step of the basic eligibility conditions for the CGT concessions.

Effect of look-through earnout rights

Earnout arrangements are a way of structuring the sale of a business to deal with uncertainty about its value.

The contract for the sale of a business (or assets of the business) provides for an initial lump sum payment by the buyer and a right to

subsequent financial benefits that are contingent on the performance of the business for a specified period after the sale.

Working out the net value of your CGT assets for the purpose of the maximum net asset value test may require you to value an asset that is subject to a look-through earnout right.

However, depending on your situation, you may be entitled to make a choice to treat the market value of the relevant CGT asset as one of the following:

- the first element of the cost base
- zero
- the total financial benefits provided
- the capital proceeds.

If such a choice is made and the look-through earnout right is also your CGT asset, you treat the market value of that right as if it were zero.

QC 52270

Active asset test

To be eligible for small business CGT concessions, your asset must pass the active asset test among other conditions.

Last updated 30 August 2023

To be eligible for the small business CGT concessions your asset must pass the active asset test among other conditions.

Meeting the active asset test

An asset passes the active asset test if it has been an active asset of yours for at least:

- 7.5 years during the test period (if you've owned it for more than 15 years)
- half of the test period (if you've owned it for 15 years or less).

The test period begins when you acquired the asset and ends at whichever occurs first:

- the capital gains tax (CGT) event relating to the asset
- the business ceases or is sold, if the CGT event occurred 12 months or less after this.

You can apply for an extension of time if you dispose of the asset more than 12 months after the business ceases or is sold.

The period in which the asset is your active asset during the test period does not need to be continuous so long as the total length of time adds up to the minimum period or more.

Example: meeting the active asset test

Jodie ran a florist business from a shop she owned for 8 years. She ran the business for 5 years.

She then leased the shop to an unrelated party for 3 years before selling it.

The shop meets the active asset test because it was actively used in Jodie's business for more than half the period of ownership, even though it was not used in the business just before it was sold.

Active assets

A CGT asset is an active asset if you (or your **affiliate or entity connected with you**) use it, or hold it ready for use, in running a business (or if it is an intangible asset, it is inherently connected with the business).

An asset whose main use is to derive rent, interest, an annuity, royalties, foreign exchange gains usually cannot be an active asset. However, the asset can be active if either:

- the main use for deriving rent was only temporary
- it is an **intangible asset** whose market value has substantially increased as a result of improvement or development undertaken by you.

Example: intangible asset considered active asset

In 2018, Jasminka opens a restaurant called Dossier and registers the name in NSW.

The concept proves to be very popular and in 2019 Jasminka registers the name Dossier Australia wide. She also registers the Dossier logo as a trademark. During this time, she licenses the use of the name in a number of cities.

In 2023 Jasminka sells the Dossier trademark.

In this situation, the Dossier trademark would be an active asset. This is because the work Jasminka did in opening the original restaurant, together with her efforts in protecting, marketing and licensing 'Dossier', is considered substantial development so that its market value has been substantially increased.

When an asset is 'held ready for use'

For an asset to be held ready for use in running a business, it needs to be in a state of preparedness for use in the business and functionally operative. As such, premises still under construction, or land on which you intend to construct business premises, cannot be said to be 'held ready for use' and would, therefore, not be active assets at that time.

Assets that are not active

The following assets cannot be active assets:

- assets whose main use is to derive:
 - [rent](#) (unless use for deriving rent was only temporary, or it is an intangible asset whose market value has substantially increased due to improvement or development you have undertaken)

- interest
 - an annuity
 - royalties
 - foreign exchange gains.
- [subdivided vacant land](#)
 - shares in companies or interests in trusts (unless they meet the [80% test](#))
 - shares and trust interests in widely held entities (unless held by a CGT concession stakeholder in the **widely held entity**)
 - financial instruments such as:
 - bank accounts
 - loans
 - debentures
 - bonds
 - futures and other contracts and share options.

Assets that derive rent

When an asset's main use is to derive rent (unless such use is temporary) it is not considered an active asset. This is the case even if the asset is used in running a business.

Whether an asset's main use is to derive rent depends on the circumstances of each case. A key factor in determining whether an occupant of premises is a lessee paying rent is whether they have a right to exclusive possession. Other relevant factors to consider in regard to exclusive possession include the degree of control retained by the owner and the extent of any services provided by the owner such as room cleaning, provision of meals, supply of linen and shared amenities.

For example, if premises are leased to a tenant under a lease agreement granting exclusive possession, the payments involved are likely to be rent. On the other hand, if the arrangement allows the

person only to enter and use the premises for certain purposes and does not amount to a lease granting exclusive possession, the payments involved are not likely to be rent.

An asset that is leased to a connected entity or affiliate for use in its business may still be an active asset. It is the use of the asset in that entity's business that will determine the active asset status of the asset.

All uses of an asset are considered in determining what the main use of the asset is and, therefore, whether it is an active asset. However, personal use of the asset by you or an individual who is your affiliate is not considered in determining the main use of the asset.

The use of the asset to derive rent from a third party (an entity not an affiliate or connected with the asset owner) will be considered use to derive rent, even if that entity uses the asset in their business. This is because the use of the asset by the asset owner is to derive rent.

However, use of the asset by a relevant entity (an entity that is an affiliate or connected with the asset owner) is treated as the use by the asset owner, even if the asset owner receives rent from the relevant entity for the use of that asset. This means, if the relevant entity uses the asset:

- in its business, that use is treated as use by the asset owner to run a business
- to derive interest, rent, royalties, or foreign exchange gains from an entity that is a third party, that use is treated as use by the asset owner to derive passive income.

Example: asset's main use is to derive rent

Rachael runs a business renting properties for short periods of time on an online platform. The terms and conditions state that tenants have exclusive possession of the properties. This means the tenant has permission to exclusively use and occupy the property. Rachael offers no additional services to the tenants during their stay and tenants are expected to provide their own linen and clean the property before vacating.

The properties are not active assets because their main use is to derive rent. Therefore, Rachael would not meet the basic eligibility conditions for the small business CGT concessions.

Example: asset's main use is not to derive rent

Tanya owns a motel (land and buildings), which she uses to run a business.

As part of the business, the motel provides room cleaning, breakfast, laundry and other services.

Guests staying in the motel do not receive exclusive possession. But simply have a right to occupy a room under certain conditions.

The usual length of stay by guests is between one and seven nights.

The motel is an active asset because its main use is not to derive rent.

Example: an asset's mixed use

Michael owns land, which holds 3 industrial sheds.

He uses one shed (45% of the land by area) to conduct a motorcycle repair business.

He leases the other 2 sheds (55% of the land by area) to unrelated third parties.

The income derived from the motorcycle repair business is 80% of the total income (business plus rentals). This is derived from the use of the land and buildings.

In determining main use of the land, a range of factors must be considered.

In this case, a substantial (although not a majority) proportion (45%) of the land is used for business purposes.

The business proportion of the land derives the vast majority (80%) of the total income.

Given all the circumstances, we consider the main use of the land is not to derive rent. Therefore, the land is an active asset.

Subdivided land

When the original parcel of land is subdivided into new blocks, these are considered new, separate assets.

If land is subdivided into both vacant land and land used to run a business, the new subdivided blocks of vacant land are not active assets.

For CGT purposes, when an asset is split into 2 or more assets you are the owner of both the original asset and the new assets, the split is not a CGT event. You work out the cost base and reduced cost base of each new asset as set out in [subdividing and combining land](#).

Example: subdivided land assets

Tom acquired 10 hectares of land as a single parcel 20 years ago.

He uses 3 distinct areas of land for different purposes:

- 20% is used for his business
- 20% is used for domestic purposes and contains his main residence
- 60% is vacant and has not been used or held ready for use.

Tom decides to subdivide all the land into residential blocks. Tom is not running a land development business so the subdivided blocks will not be trading stock. After the subdivision is complete, Tom will sell each block, including those created out of the vacant part of the land.

The new subdivided blocks are considered to be acquired by Tom when the original parcel was acquired. The disposal of a subdivided block is treated as the disposal of an asset in its own

right, and not as a disposal of part of an asset (the original land parcel).

The new subdivided blocks created out of the:

- 20% part of land where Tom ran the business will meet the active asset test when they are sold. This is because they were owned for more than 15 years and were active assets for at least 7.5 years.
- 20% which contains his main residence is exempt from CGT because Tom meets the main residence exemption eligibility conditions.
- 60% part of the vacant land are new assets that have never been used or held ready for use in any business. Therefore, they are not considered active assets.

The 80% test

Shares in a company that is an Australian resident at the time you own them or an interest in a trust that is a resident for CGT purposes for the income year in which you own that interest can be active assets if they meet the 80% test.

The test is met if the market value of the company or trust's active assets and financial instruments and cash (those that are inherently connected with the business) make up at least 80% of the market value of all of the company or trust's assets.

Inherent connection

Inherent connection requires more than just some form of connection between the cash or financial instrument and the business. Examples of things inherently connected to a business include:

- a permanent or characteristic attribute of the business — for example, goodwill or trade debtors (invoices owed to you by customers)
- excess funds the business has as a result of
 - a temporary spike in trading activity
 - the sale of a business asset

- a financial instrument that is inherently connected with a business that the owner of the financial instrument runs (rather than any business a related entity runs).

Example: loan to a related company

Archimedes Pty Ltd is a manufacturing business. It lends \$300,000 to a related company, Galileo Pty Ltd, to acquire assets for business use between both companies.

The loan is made between members of a corporate group as part of the overall financing of the group.

However, the loan is not a permanent or characteristic attribute of the business (which is manufacturing, not the acquisition of assets). It is a financial instrument but not inherently connected with the business of manufacturing.

Therefore, the \$300,000 loan is included in the total market value of all the assets, but not included as an active asset.

The market value of Archimedes Pty Ltd.'s active assets is \$700,000 (without the loan). The market value of all its assets (including the loan) is \$1 million.

The 80% test calculation is:

$$\$700,000 \div \$1 \text{ million} = 70\%$$

This means that the 80% test is not met.

Temporary breaches of the 80% test

The 80% test will be considered to be met where the total market value of the active assets falls below 80% of the total market value of the company or trust and:

- this is only temporary in nature
- it is reasonable to conclude that the 80% threshold has been passed.

Depreciating assets, such as plant, are CGT assets. They can be active assets and included in the 80% test.

Example: temporary breach due to borrowing money

Joshua owns a fruit shop. He sells an active asset that meets the basic CGT eligibility conditions. He makes a capital gain on the asset.

Later, he acquires shares in Fruit and Veg Co as replacement assets. Fruit and Veg Co runs his family business.

The shares Joshua acquired meet the 80% test. As a result, they are active assets.

Several years later, Fruit and Veg Co borrows money to pay a dividend and fails the 80% test.

Two weeks later they pay the dividend and the shares pass the 80% test again.

For the 2 interim weeks, the shares Joshua acquired in Fruit and Veg Co are treated as active assets.

Active asset test for involuntary disposals

There are modified rules to determine if the active asset test is met for CGT assets acquired or transferred under the rollover provisions relating to assets compulsorily acquired, lost or destroyed, or to marriage and relationship breakdown.

If you acquired a replacement asset to meet the rollover requirements for the involuntary disposal of a CGT asset, the replacement asset is treated as if:

- you acquired it when you acquired the original asset
- it was an active asset (at all times) when the original asset was an active asset.

If a CGT asset is transferred to you from a relationship breakdown and you roll over the capital gain that arises from that transfer, you can choose whether to:

- include the ownership and active asset periods of your former spouse

- commence the ownership and active asset periods from the time the asset was transferred to you.

If you choose to include the ownership and active asset periods of your former spouse, the asset is treated as if it had been:

- acquired by you when your former spouse acquired the asset
- an active asset of yours (at all times) when the asset was an active asset of your former spouse.

Creating rights – modified active asset test

The active asset test normally requires you to own the CGT asset before the CGT event occurs.

However, when CGT event D1 occurs (creating rights in another entity), the relevant CGT asset (the rights) is created in the other entity without you owning it. Therefore, it would not be possible to meet the active asset test. In this case, the active asset test is modified and requires the right you create (that triggers the CGT event) to be inherently connected with another CGT asset that meets the active asset test.

Assets you inherit from a deceased person

You may be eligible for the CGT concessions to the same extent that the deceased would have been just prior to their death if you receive the asset as a:

- beneficiary of a deceased estate
- legal personal representative (LPR)
- surviving joint tenant
- trustee or beneficiary of a testamentary trust (trust created by a will).

You will be eligible for the concessions where the CGT event relating to the asset occurs within 2 years of the individual's death.

Otherwise, the active asset test applies to you in the normal way for any capital gain made on a sale of the assets after the 2-year time limit. This means that if you do not continue to run the deceased's business, or use the asset in another business, after the 2 years, the

active asset test may not be met, and the small business concessions may not be available.

We can extend the 2-year time period in certain situations.

QC 52271

Additional conditions if the CGT asset is a share or trust interest

Extra eligibility conditions for the small business CGT concessions if the asset is a share or interest in a trust.

Last updated 6 June 2023

Extra conditions for the small business CGT concessions

If the capital gains tax (CGT) asset is a share in a company or interest in a trust, you must meet the following extra conditions, in addition to the **basic eligibility conditions**, to be eligible for the small business CGT concessions:

- You either:
 - ran a business just before the CGT event
 - meet the maximum net asset value test
- Just before the CGT event, either:
 - you were a [CGT concession stakeholder](#) in the company or trust
 - the CGT concession stakeholders in the company or trust had a total [small business participation percentage](#) of at least 90% ([the 90% test](#))
- The company or trust, when applying the [modified connected entity rule](#) in determining entities controlled by it, must either:
 - be a small business entity for the income year
 - meet the maximum net asset value test.

- Your shares or interest must meet the [modified active asset test](#).

Who is a CGT concession stakeholder

You are a CGT concession stakeholder of a company or trust if you are either:

- a [significant individual](#)
- the spouse of a significant individual and you have a small business participation percentage in the company or trust that is more than zero.

You can hold the small business participation percentage directly or indirectly through one or more interposed entities.

You work out the small business participation percentage in the same way as the significant individual test.

Significant individual test

You are a significant individual in a company or trust if you have a small business participation percentage in the company or trust of at least 20%. This 20% can be made up of direct and indirect percentages.

A company or trust meets the significant individual test if it had at least one significant individual just before the CGT event.

Small business participation percentage

An entity's small business participation percentage in another entity's test time is the sum of the entity's:

- [direct small business participation percentage](#) in the other entity at that time
- [indirect small business participation percentage](#) in the other entity at that time.

Direct small business participation percentage

Companies

An entity's direct small business participation percentage in a company is the **smallest** percentage out of:

- the percentage of the voting power in the company that the entity is entitled to exercise (except for jointly owned shares)
- the percentage of any dividend payment that the entity is entitled to receive
- the percentage of any capital distribution that the entity is entitled to receive.

The smallest percentage could be 0%. This could be if shares do not have voting rights or if the shares do not carry a right to capital distributions or dividends.

Take all classes of shares (other than redeemable shares) into account when determining an entity's participation percentage.

Ignore the voting power calculation for jointly owned shares because neither owner individually controls the voting power.

Example: significant individual holding 2 classes of shares in a company

Brave Company has 2 different classes of shares, A and B, which have equal voting and distribution rights.

The directors of the company can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares.

Isaac holds 22% of each class of shares. This means he:

- will receive 22% of any distribution made by the company, regardless of how the directors exercise their discretion
- holds 22% of the voting power through each class of shares.

Isaac is a significant individual because his smallest small business participation percentage in the company is 22% (and it must be at least 20%).

Trusts

An entity's direct small business participation percentage in a trust, where entities have entitlements to all the income and capital of the trust, is the lower percentage of either the:

- income of the trust that the entity is beneficially entitled to
- capital of the trust that the entity is beneficially entitled to.

An entity's direct small business participation percentage in a trust (where entities do not have entitlements to all the income and capital of the trust, and the trust makes a distribution of income or capital) is the lower percentage of either distributions of:

- income that the entity is beneficially entitled to during the income year
- capital that the entity is beneficially entitled to during the income year.

Discretionary trusts with tax losses or no net income

An entity can use another method to work out their small business participation percentage in a discretionary trust if, in the CGT event year, both:

- the trustee did not make a distribution of income or capital during the income year
- the trust had no net income or had a tax loss for the income year.

The entity's direct small business participation percentage at the relevant time is the percentage of the distributions the entity was beneficially entitled to in the last income year before the CGT event in which the trustee made a distribution.

An entity's small business participation percentage is zero if either the:

- trust had net income and did not have a tax loss, and the trustee decided not to distribute
- trustee has never made a distribution in the income years up to and including the CGT event year (including where the trust had no net income or had a tax loss in each of those income years).

Example: significant individuals of a discretionary trust with no distribution and tax loss

After a bad trading year, XYZ Trust:

- sells its shares in an operating company and makes a capital gain

- makes no distributions in the CGT event year
- has an overall tax loss.

In the year prior to the CGT event year, the trustee makes a distribution of income to the following beneficiaries as:

- 21% to Evangeline
- 23% to Dennis
- 25% to Katrin.

Evangeline, Dennis and Katrin all have a small business participation percentage in XYZ Trust of at least 20%. This makes them significant individuals and CGT stakeholders in XYZ Trust.

Indirect small business participation percentage

An entity's indirect small business participation percentage in a company or trust is the entity's direct participation percentage in an interposed entity multiplied by the interposed entity's total participation percentage (both direct and indirect) in the company or trust.


An indirect interest can be held through one or more interposed entities.

If a trust has a tax loss or no net income for the income year, a beneficiary of a discretionary trust may calculate their indirect small business participation percentage to be more than zero.

Example: calculating the participation percentage of a trust to determine significant individuals

ABC Trust owns 100% of the shares in Operating Co. Therefore, ABC Trust has a 100% direct interest (and no indirect interest) in Operating Co.

Jennifer, Bill and Nicky are the beneficiaries of ABC Trust.

 Diagram showing how to work out your small business participation percentage. ABC Trust pays Bill 15% of distributions, Jennifer (his spouse) 80% of distributions, and Nicky 5% of distributions.

Jennifer

Jennifer receives 80% of the distributions from ABC Trust. Therefore, she has a direct participation percentage of 80% in ABC Trust.

Jennifer's participation percentage in Operating Co is calculated by multiplying Jennifer's direct participation percentage in ABC Trust and ABC Trust's total participation percentage in Operating Co:

- $80\% \times 100\% = 80\%$

Jennifer has an 80% participation percentage in Operating Co, so she is a significant individual of Operating Co.

Bill

Jennifer's spouse, Bill, receives 15% of the distributions from ABC Trust. Therefore, he has a direct participation percentage of 15% in ABC Trust.

Bill's participation percentage in Operating Co is calculated by multiplying his direct participation percentage in ABC Trust and ABC Trust's total participation percentage in Operating Co:

- $15\% \times 100\% = 15\%$

Bill has a 15% participation percentage in Operating Co, so he is not a significant individual of Operating Co.

However, as a spouse of a significant individual with a participation percentage greater than zero in the entity, Bill will be a CGT concession stakeholder.

Nicky

Nicky receives 5% of the distributions from ABC Trust. Therefore, she has a direct participation percentage of 5% in ABC Trust.

Nicky's participation percentage in Operating Co is calculated by multiplying her direct participation percentage in ABC Trust and ABC Trust's total participation percentage in Operating Co:

- $5\% \times 100\% = 5\%$

Nicky has a 5% participation percentage in Operating Co, so she is not a significant individual of Operating Co. Nicky is not a CGT

concession stakeholder.

The 90% test

The 90% test only applies if there is an interposed entity between the CGT concession stakeholders and the company or trust in which the shares or interests are held. The interposed entity is the entity accessing the concessions.

The test is met if CGT concession stakeholders in the company or trust in which the shares or interest are held have a total small business percentage in the entity claiming the concession of at least 90%.

Like the significant individual test, the participation percentage can be held directly or indirectly through multiple interposed entities.

Example: the 90% test for ABC Trust

Based on the above 'Example: calculating the participation percentage of a trust to determine significant individuals':

- Jennifer, a significant individual and CGT concession stakeholder of Operating Co, has an 80% small business participation percentage in ABC Trust
- Bill, a CGT concession stakeholder of Operating Co, has a 15% small business participation percentage in ABC Trust
- Nicky, who is not a CGT concession stakeholder of Operating Co, has a 5% small business participation percentage in ABC Trust.

At least 90% of the participation percentages in ABC Trust are held by CGT concession stakeholders of Operating Co (Jennifer and Bill). As a result, ABC Trust meets the ownership requirement if it sells its shares in Operating Co, and can access the concessions on those shares, provided the other conditions are met. ABC Trust is not a CGT concession stakeholder in Operating Co because it is not an individual.


Modified connected entity rule

The company or trust must be a **small business entity** or meet the **maximum net asset value test** using the modified connected entity rule. When applying each of these tests, the company or trust must include the annual turnovers and assets of its affiliates and entities controlled by it.

Under the modified connected entity rule, the company or trust controls another entity if it has a control percentage of at least 20% in the other entity.

Any Commissioner's determination that the entity does not control another entity (**discretion about control between 40% and 50%**) is disregarded for the modified connected entity rule.

Example: entity fails modified connected entity rule

 Colour Co owns 20% of Red Co, 20% of Big Green Co and 20% of Blue Co.

Colour Co is a small business entity with an aggregated turnover of less than \$2 million.

When applying the general connected entity rule, Red Co, Big Green Co and Blue Co would not be connected with Colour Co because Colour Co holds less than 40% of shares in each of them.

However, to determine if Colour Co is a small business entity or meets the maximum net asset value test to access the small business CGT concessions, we need to apply the modified connected entity rule. This is because the CGT asset is a share in a company.

Because Colour Co owns 20% of the shares in Red Co, Big Green Co and Blue Co, Colour Co controls them. Therefore, Colour Co must include the annual turnovers in its aggregated turnover and the net asset values in the maximum net asset value test.

Big Green Co has an annual turnover of \$5 million (from dealings unrelated to Colour Co) and the net value of its assets is \$20 million. This means Colour Co would not:

- be a small business entity with an aggregated turnover of less than \$2 million

- meet the maximum net asset value test as the total net value of the assets owned by Colour Co and entities controlled by it (Red Co, Big Green Co, Blue Co) exceeds \$6 million.

Modified active asset test

In determining whether your share in a company or interest in a trust meets the modified active asset test, your share or interest must have been an **active asset** with some modifications to the 80% test.

Whilst the modified 80% test must be met for at least half of the asset ownership period, it does not need to be applied on a day-to-day basis.

When applying the modified 80% test, a share in a company or an interest in a trust will continue to be an active asset at a later time if it:

- was an active asset at an earlier time
- is reasonable to conclude that the share or interest is still an active asset at the later time.

A temporary breach of this requirement will not result in the test being failed.

Steps to work out if your share or interest meets the modified active asset test

Step 1: Work out the total market value of the entity

Work out the total market value of both:

- the assets of the company or trust
- the assets of a later entity in which the company or trust has a [small business participation percentage](#), multiplied by that percentage.

Exclude the market value of shares or interests held, directly or indirectly, by the company or trust.

Step 2: Work out the total market value of active assets

Work out the total market value of both:

- the active assets of the company or trust
- the active assets of a later entity, multiplied by that percentage.

Assets of a later entity are only active assets if both:

- the later entity, when applying the [modified connected entity rule](#), either
 - is a **small business entity**
 - meets the **maximum net asset value test** in relation to a notional capital gain; and
- you either
 - have a [small business participation percentage](#) of at least 20% in the later entity
 - are a [CGT concession stakeholder](#) of the later entity.


Step 3: Calculate the minimum 80% requirement

At least 80% of the step 1 amount must be made up of:

- active assets (the step 2 amount)
- cash or financial instruments that are **inherently connected** with a business run by the company or trust, or a later entity.

Any cash or financial instruments acquired or held by the company or trust only for the purpose of meeting the 80% requirement are disregarded.

Example: meets the modified active asset test

 Karen owns 50% of Consulting Co. Consulting Co owns 1,000 shares in Big Co and 50% of Media Co.

Karen is a sole trader and is a small business entity with an aggregated turnover of less than \$2 million (applying the general connected entity rule) for the 2018–19 income year.

Karen owns 50% of the shares in Consulting Co, which is a small business entity with an aggregated turnover of less than \$2 million (applying the modified connected entity rule) for the 2018–19 income year.

The total market value of Consulting Co's assets (excluding the value of shares in Big Co and Media Co) is \$1 million, of which \$980,000 is the value of its active assets.

Consulting Co also owns 1,000 shares of the 10 million shares in Big Co. Consulting Co's small business participation percentage in Big Co is 0.01%. The total market value of Big Co's assets is \$100 million.

Consulting Co also owns 50% of Media Co, which is a small business entity with an aggregated turnover of less than \$2 million. The total market value of Media Co's assets is \$1.2 million, of which \$1 million is the value of its active assets.

There are no significant amount of cash and financial instruments inherently connected to the business of Consulting Co and Media Co.

There has been no significant change in the activities or holdings of Consulting Co, Big Co and Media Co over the period Karen has owned the shares.

On 20 April 2019, Karen sells her shares in Consulting Co.

The shares need to meet the modified active asset test for Karen to access the small business CGT concessions.

Step 1: Work out the total market value of the entity

The total market value of the assets in Consulting Co and other entities that Consulting Co has a small business participation percentage in (Big Co and Media Co) is **\$1.61 million**. This is the sum of:

- \$1 million (Consulting Co's assets)
- \$100 million (the value of Big Co's assets) \times 0.01% (Consulting Co's participation percentage in it) = \$10,000
- \$1.2 million (the value of Media Co's assets) \times 50% (Consulting Co's participation percentage in it) = \$600,000

Step 2: Work out the total market value of active assets

The market value of Consulting Co's active assets is \$980,000.

An asset of Media Co can only be an active asset for Consulting Co if Karen is a CGT concession stakeholder of Media Co.

Karen's small business participation percentage is 25% in Media Co, calculated as 50% (Karen's small business participation percentage in Consulting Co) \times 50% (Consulting Co's participation percentage in Media Co).

As Karen's small business participation percentage in Media Co is at least 20%, the market value of Media Co's active assets (\$500,000) is included. This is calculated as \$1 million (Media Co's active assets) \times 50% (Consulting Co's participation percentage in Media Co).

Big Co's assets are not included as Karen is not a CGT concession stakeholder of Big Co.

\$980,000 (market value of Consulting Co's active assets) +
\$500,000 (market value of Media Co's active assets) =
\$1.48 million.

Step 3: Calculate the minimum 80% requirement

Karen's shares meet the modified active asset test because:

- \$1.48 million (the step 2 amount) \div \$1.61 million (the Step 1 amount) = **92%**

there have been no significant changes to the activities or holdings of the relevant entities during the ownership period.

Capital gains made before 8 February 2018

If you made a capital gain relating to shares in a company or an interest in a trust before 8 February 2018, there are fewer conditions you need to meet to be eligible.

You must meet the basic CGT concessions eligibility conditions and just before the CGT event you must either:

- be a CGT concession stakeholder in the company or trust
- meet the [90% test](#).

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