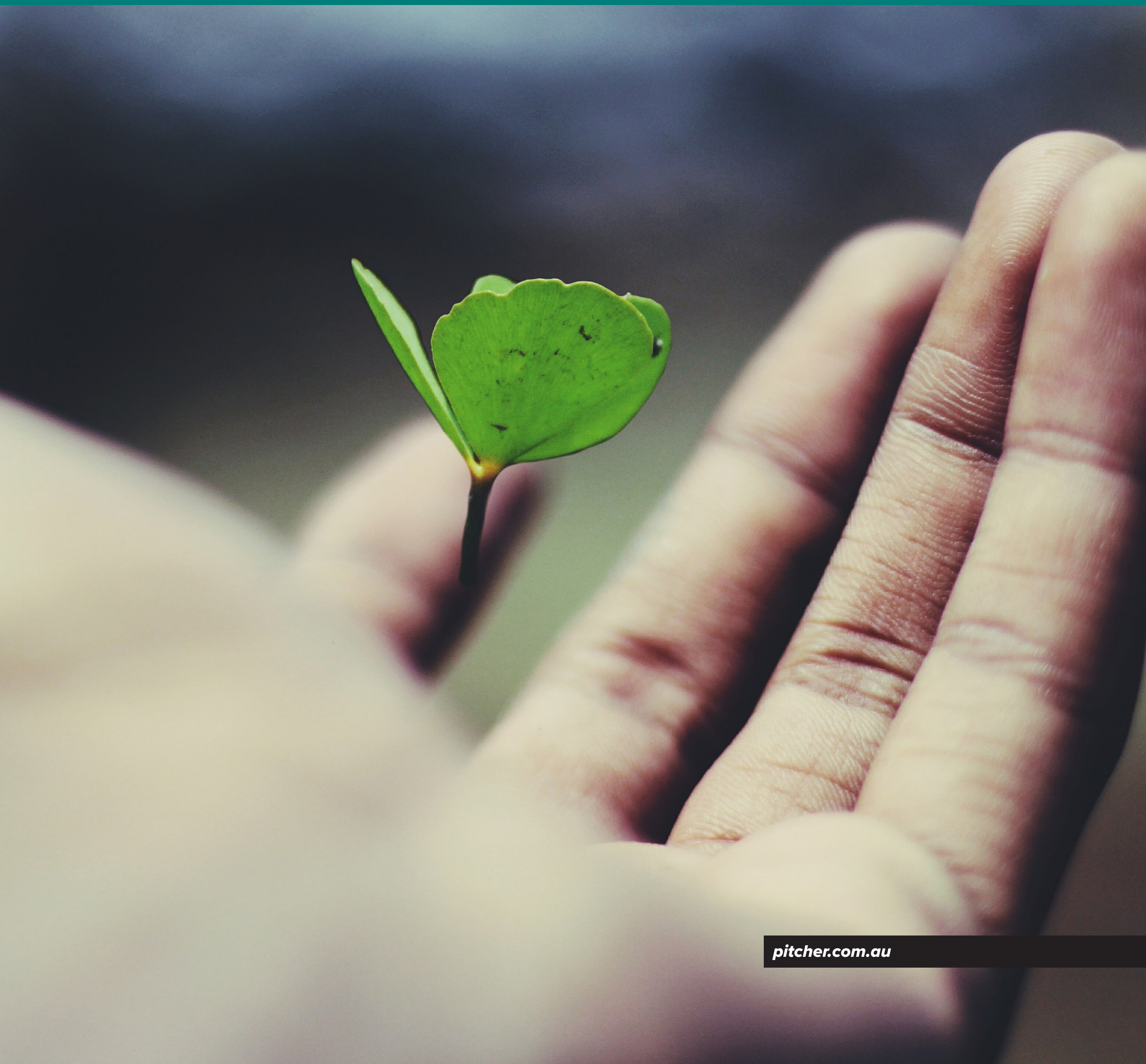
Wealth Update

Autumn 2021



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Welcome to our latest Wealth Management Update.

This edition covers the following topics:

- Funding retirement: small business owners
- Reporting season update
- Year-end super contributions and concessions

Funding retirement: small business owners

For many business owners, their business represents a large part of their individual wealth and is integral to funding a comfortable life in retirement. In this article we look at the options available to business owners who are seeking to bolster their retirement savings when exiting their business. Specifically, we'll be exploring the Capital Gains Tax (CGT) concessions and superannuation caps available to small business owners.

When Federal Treasurer Peter Costello announced the introduction of the small business concessions in 1999, he stated the objective was to provide "small business people with access to funds for retirement". As business owners often reinvest cashflow into their business, they do not necessarily have the same ability to access the concessionary superannuation environment as PAYG employees. We provide an overview of the concessions for general understanding; however, this article is not exhaustive in exploring all aspects of the applicable legislation. Advice should be sought from a tax adviser to understand how the concessions apply to your situation.

Who is a small business owner?

To qualify for the small business CGT concessions the "basic conditions" must be met. Firstly, one of the following conditions will need to be satisfied:

- **The total net value of CGT assets owned must not exceed $6m.**

  Assets held within entities connected to the individual, or controlled by them, will typically need to be included under this cap. However, it does not include personal use assets, such as the family home or car.

- **The individual is carrying on a business which has aggregated turnover of less than $2m.**

  There are three different methods which can be used to calculate aggregated turnover.

If the individual doesn't carry on business, or is a partner in a partnership, there are variations of the above criteria that can apply.

It is also important to consider which entity is disposing of the asset as the tax implications vary significantly. As an example, an individual selling shares in their company will be treated differently to the company itself selling business assets.

The "active asset test"

The second step is that the asset being sold must satisfy the "active asset test". This test will be met if the asset is either:

- Used in the course of carrying on a business. i.e. a shop-front or business premise; or
- An intangible asset inherently connected with a business; i.e. goodwill.

The asset will need to have met one of these two conditions for at least:

- Half the time owned, if owned for less than 15 years; or
- 7.5 years if owned for more than 15 years.

Examples of assets that are unlikely to meet the active asset test are inventory, non-CGT assets, machinery or assets that depreciate. There are also additional conditions that apply if the asset is a share or trust interest.

Reducing the taxable gain

Having met the basic conditions, there are four exemptions that a retiring business owner may apply to improve their after-tax financial position, **in addition to the general discount**:

1. 15-year exemption
2. Active asset reduction
3. Retirement exemption
4. Small business roll-over

15-year exemption

The holy grail of CGT concessions is the 15-year exemption. You will have no assessable capital gain (i.e. no tax to pay) where:

- The asset has been **continuously owned for 15 years or more**, and
- The business owners are **aged 55 or over** and the CGT event occurs (i.e. the sale) **in connection with retirement**.

If the 15-year exemption is met, the remaining concessions will not need to be used.

Active asset reduction

The assessable gain can be reduced by a further 50%, in addition to the general discount. Having already met the basic criteria, **no further eligibility criteria applies**.

Retirement exemption

Taxpayers have a lifetime limit of $500k which can be used to disregard all or part of a remaining gain. The retirement exemption and active asset discount can be used in either order, giving flexibility to the amount of the gain that is disregarded. This is relevant and discussed in the interaction with superannuation section set out below.

Despite the name, you don't actually need to retire to apply this concession. The only additional criteria that applies is **where the individual is under age 55, the amount disregarded must be contributed to superannuation**. For those 55 or over, contributing the disregarded amount to super is optional.

Small business roll-over

The small business roll-over allows you to disregard all of a remaining capital gain for up to two years in order to utilise the proceeds from the gain to reinvest in a replacement asset. The replacement asset must be an eligible asset, which broadly means an active asset. Where a replacement asset is acquired within the time period the capital gain will be deferred until that replacement asset is disposed of or ceases to be an active asset. Where no replacement asset is acquired the previously disregarded capital gain occurs. This allows you to defer any remaining capital gain (and the associated tax liability) for a further two years. We have not discussed this further within this article as it is less likely to be used by a business owner seeking to fund retirement.

General discount

The general discount allows you to reduce your assessable capital by 50% and is available where the **asset has been owned for greater than 12-months**.

We note that the discount may be a lower amount depending on the structure of the business. Additionally, where the asset was acquired before 21 September 1999, the indexation method may also be applied.

Interaction with superannuation

Where the conditions of either the "15-year exemption" or the "retirement exemption" are met, an individual may be eligible to use their super CGT cap. Where these concessions are used, the taxpayer must notify their super fund provider or trustee in the case of a self-managed superannuation fund:

- Where the contribution is made in conjunction with the 'retirement exemption', the maximum that can be contributed is the lesser of:
  - $500,000; or
  - The remaining gain (after applying the general discount, any capital losses and a chosen amount of the active asset discount).

  Recall from above that individuals under age 55 must contribute the amount disregarded to super when using the "retirement exemption",
- Where the "15-year exemption" has been applied, **up to $1.565m can be contributed to superannuation**. This is a lifetime limit, and is indexed, so it increases every year.

Where contributions are made under the CGT cap:

- The contribution does not count toward the non-concessional contributions cap, which is currently $100,000 p.a.
- Contributions tax does not apply.

Case study

To illustrate how the concessions would be applied, we have created a simplistic scenario where the business owner is eligible for all concessions, except for the 15-year exemption.

Andrew is aged 53 and will be retiring permanently. He will be selling the business that he started ten years ago (zero cost base) for $2.1m. Andrew has never used his superannuation CGT cap and has $100,000 in crystallised capital losses from a prior financial year.

Andrew meets the basic conditions on the basis that:

- His net assets are less $6m; and
- He is selling the business goodwill and office premise (i.e. these are active assets).

	Concession value	Remaining assessable gain	
Gain made on business sale		$2,100,000	
15-year exemption	$0	$2,100,000	Not eligible as Andrew has not owned his business for 15-years
Offset capital losses against the gain	$100,000	$2,000,000	
General discount	$1,000,000	$1,000,000	50% discount applied
Active asset reduction	$500,000	$500,000	Further 50% reduction applied
Retirement exemption	$500,000	$0	Remaining gain disregarded and contributed to superannuation as Andrew is under age 55

Additional comments

- As only $500,000 of the sale proceeds have been contributed to superannuation, Andrew and his spouse could then consider using the bring-forward provisions to make non-concessional contributions of a further $600,000 into superannuation (combined).
- Had Andrew met the conditions of the “15-year exemption”, up to $1.565m of the sale proceeds could have been contributed to super, before making the non-concessional contributions.

Conclusion

It is important to have a plan in place well before the sale occurs. The sale of a business will be a significant change to the individual’s circumstances and an opportunity to take advantage of some very attractive concessions. Having the right plan in place will help you transition from successful business-owner to a well-funded retiree.

We’ve covered the concessions from a wealth management and retirement planning perspective. This article does not cover every aspect relevant to the small business concessions discussed. Nor is it intended to cover all concessions that may be applicable. Before selling your business, engage with your advisers to ensure you have a clear understanding of all options available.

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Reporting season update

During the pandemic, we positioned our portfolios into companies that we believed would be able to generate significant revenues despite the global turmoil. Although the February reporting season validated this approach, the strong results overall were broadly factored into share prices following moderate gains throughout the second half of 2020. Subdued outlook statements led to some post-reporting weakness.

A summary of some of the results of long-term holdings follows:

Amcor Plc (AMC)

Result	H1FY21
Key details	GAAP net income increased 65% to US$417m, GAAP EPS was 71% higher to US$0.265 per share. Adjusted EPS rose 16% in constant currency terms to US$0.333. A dividend of US$0.1175 was declared (AU$0.1521), slightly higher than the pcp.
Outlook	AMC upgraded full year EPS guidance to between 10% and 14% in constant currency, from a previous range of between 7% and 12%.
Conclusion	Solid result with sound growth in volumes, accompanied by a strong outlook. Currency headwinds only negative.

Appen Limited (APX)

Result	H1FY21
Key details	Revenue increased 12% to $600m, underlying EBITDA rose 8% to $109m and statutory EBITDA grew 23%. China revenue increased 60% quarter on quarter.
Outlook	Full year underlying EBITDA for FY21 expected to be between $120m and $130m, representing growth of between 18% and 28% on FY20 underlying EBITDA (excluding a foreign exchange gain) of $102m.
Conclusion	Result was solid but below analyst expectations as COVID-19 led to fewer B2B sales and reduced advertising spend. This weakness should prove temporary as the economy reopens.

ASX Limited (ASX)

Result	H1FY21
Key details	Operating revenue increased 3% to $471m. NPAT was 3% lower to $242m, equating to an EPS of $1.25. A dividend of $1.12 per share was declared, reflecting an unchanged 90% payout ratio.
Outlook	The company stated that it does not expect H2FY21 to be as volatile as H1FY21, though mixed trading conditions are expected to continue.
Conclusion	The ASX downgraded their FY21 guidance on higher expenses and capital expenditure (Capex). Initial Public Offerings (IPO's) continue to support revenues.

BHP Billion (BHP)

Result	H1FY21
Key details	Group revenue increased 15% to US$25.6b. Profit from operations rose 17% to US$9.8b. Underlying attributable profit of US$6.0b was 16% higher.
Outlook	BHP believes the commodity outlook over the next year will be mixed, however the worst of the physical demand shock from COVID-19 is likely to have passed. The re-emergence of outbreaks and their subsequent management is the main source of uncertainty in the outlook.
Conclusion	BHP's result benefitted from the strong rise in commodity prices, offsetting currency headwinds, rising costs and increased capex.

CarSales.com Limited (CAR)

Result	H1FY21
Key details	Reported revenue was 7% lower at $199m. Reported EBITDA was 9% higher at $114m. NPAT decreased 14% to $61m. Reported EPS was 15% lower at $0.248. An interim dividend of $0.25 per share was declared, 14% higher than the pcp.
Outlook	The company forecast moderate adjusted revenue growth and solid adjusted EBITDA and adjusted NPAT in FY21, assuming a continuation of the current operating environment for the balance of the second half of the year. The company notes significant uncertainty remains given the COVID-19 pandemic.
Conclusion	The result was negatively impacted by higher costs and dealer initiatives to minimise the effects of lockdowns, predominantly in Victoria. Performance in Brazil and South Korea was solid.

Coles Group (COL)

Result	H1FY21
Key details	Sales revenue was 8% higher at $20.38b, EBIT rose 12% to $1.0b. NPAT increased 15% to $560m, leading to an EPS of $0.42. An interim dividend of $0.33 was declared, 10% higher than the pcp.
Outlook	Coles noted that over recent months Australia has successfully managed to avoid a large scale COVID-19 outbreak, however, short term outbreaks have impacted a number of cities and communities across Australia. Depending on the vaccine roll-out and efficacy, and other factors, sales in the supermarket sector may moderate significantly or even decline in the second half of FY21 and into FY22.
Conclusion	The company's outlook of slowing growth was not surprising as the economy normalises, with consumers increasing spending in restaurants and bars, offsetting decreased home consumption.

CSL Limited (CSL)

Result	H1FY21
Key details	Total revenue (at constant currency) was 15% higher at US$5.65b, EBIT increased 42% to US$2.32b and NPAT was 44% higher at US$1.79b, leading to an EPS of US$3.95. The company declared an interim dividend of US$1.04, 9% higher than the pcp.
Outlook	The company stated that demand for CSL's core plasma, and influenza vaccine products remains robust. The company forecasts that FY21 NPAT is anticipated to be in the range of approximately US$2.17b to US$2.27b at constant currency, representing growth over FY20 of up to 8%.
Conclusion	CSL reported a solid result, benefiting from lower operating expenses. Current plasma collection levels continue to be well below those pre-COVID-19.

Kogan.com Limited (KGN)

Result	H1FY21
Key details	Gross sales rose 97% to $638m, EBITDA was 132% higher at $39m. NPAT rose 165% to $24m. Adjusted NPAT (removing non-cash items) was 250% higher at $37m, translating into an adjusted EPS of $0.35. An interim dividend of $0.16 per share was declared, more than double that of the pcp.
Outlook	The company expects H2FY21 to deliver further growth in Exclusive Brands, the scaling up of Kogan Marketplace and integration of the Mighty Ape team and operations, and further growth in the Group's Active Customer base.
Conclusion	Kogan continues to grow its customer base strongly, leading to strong revenue growth. The share price has retreated significantly but the growth runway remains intact.

Nuix Limited (NXL)

Result	H1FY21
Key details	Statutory revenue was $85m, 4% lower than the pcp. Annual Contract Value (ACV) of $162m was 3% higher and pro-forma EBITDA of $32m increased 3% on the pcp. NPAT was 20% lower to $10m.
Outlook	NXL re-affirmed FY21 forecasts, as per the IPO prospectus, of total revenue of $194m, ACV of $200m and pro-forma EBITDA of $64m.
Conclusion	The strong AUD significantly impacted revenue, partly offset by an increase in recurring revenues, whilst new business sales grew strongly. Reaffirmation of previous guidance implies a skew in both revenue and profit towards the second half.

Resmed CDI (RMD)

Result	Q2FY21
Key details	Revenue increased 9% to US$800m (7% on a constant currency basis). Net operating profit increased 12% to US$180m. GAAP diluted EPS increased 12% to US$1.23.
Outlook	The company did not provide a specific outlook.
Conclusion	RMD's results were solid and the company continues to benefit from the pandemic and demand for its devices is likely to be elevated over the short to medium term.

Rio Tinto Limited (RIO)

Result	FY20
Key details	Consolidated sales revenue rose 3% to US$44.6b. Underlying EBITDA was 13% higher at US$23.9b and NPAT increased 22% to US$9.8b, leading to an EPS of US$7.70. The company declared a US$3.09 final dividend and a US$0.93 special dividend, taking the total dividend to US$5.57.
Outlook	RIO believes that the Chinese economy is transitioning to a more broad-based upswing in consumption and private sector investment, whilst over the longer term the trend of income growth in emerging markets will continue to drive global commodity demand.
Conclusion	RIO's results benefitted from the strong rise in commodity prices and the price of iron ore in particular, the iron ore division contributing around 80% of the Group's profits.

Sonic Healthcare (SHL)

Result	H1FY21
Key details	Revenue grew 33% to $4.4b, EBITDA increased 89% to $1.3b, whilst NPAT was 166% higher to $678m. An interim dividend of $0.36 was declared, 6% higher than the pcp.
Outlook	SHL stated that its outlook is dependent on the potential fluctuation in base business and COVID-19 testing revenues. There is potential for growing demand for COVID-19 serology testing.
Conclusion	The tailwinds from COVID-19 can clearly be seen in SHL's results and are likely to support revenues over the short term.

Steadfast Group Limited (SDF)

Result	H1FY21
Key details	Underlying revenue of $438m was 7% higher than the pcp, underlying NPAT increased 19% to $60m, leading to an underlying EPS of $0.07, a rise of 17%. An interim dividend of $0.044 was declared, an increase of 22%.
Outlook	SDF now expects to deliver at the top end of guidance range based on strong first half trading performance and accretive acquisitions. SDF confirmed FY21 guidance of underlying EBITA of between $245m and $255m, underlying NPAT of between $120m and $127m and underlying diluted EPS growth of between 10% to 15%.
Conclusion	SDF's results were solid with strong organic growth of 16%, whilst acquisitions also contributed to revenue growth during H1FY21.

Telstra Corporation Limited (TLS)

Result	H1FY21
Key details	Total income was 10% lower at $12.0b. EBITDA declined 15% to $4.1b. NPAT was 2.2% lower at $1.1b, leading to an EPS of $0.092. An interim dividend of $0.05 in addition to a special dividend of $0.03 were declared.
Outlook	TLS has lowered its FY21 income guidance by around 5% to between $22.6b to $23.2b from prior guidance. Underlying EBITDA for H2FY21 is now expected to be in the range of $3.3b to $3.6b and underlying EBITDA for FY21 is now expected to be between $6.6b to $6.9b.
Conclusion	Telstra's result was sound and supported by aggressive cost-cutting.

Transurban Group (TCL)

Result	H1FY21
Key details	Proportional toll revenue decreased 17% to $1.2b. Proportional EBITDA and before significant items decreased 23% to $840m. The company recorded a statutory loss of $448m (including discontinued operations). The company declared a H1FY21 interim distribution of $0.15 per stapled security.
Outlook	The FY21 distribution is expected to be in line with Free Cash, excluding capital releases.
Conclusion	Although TCL is recovering from COVID-19 restrictions, traffic is still being significantly impacted, most notably in the US. Revenues are likely to bounce back towards pre-COVID-19 levels once restrictions ease further.

Wesfarmers (WES)

Result	H1FY21
Key details	Revenue was 17% higher to $17.74b, EBIT rose 25% to $2.17b, NPAT increased 26% to $1.41b, equating to an EPS of $1.25. An interim dividend of $0.88 was declared, 17% higher than the pcp.
Outlook	Wesfarmers noted that economic conditions in Australia have recovered strongly and the outlook is more positive, subject to future COVID-19 risks. While the continued impact of COVID-19 on customer demand and operations presents significant uncertainty, Wesfarmers believes that its portfolio of cash-generative businesses with leading market positions remains well-placed to deliver satisfactory shareholder returns over the long term.
Conclusion	A very strong result. Great business but as less people work from home and stimulus measures fade, it will be cycling high comparable sales which may see its share price plateau in the short run.

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Year-end superannuation contributions and concessions

With the financial year-end fast approaching, there is still time to take advantage of the various superannuation contribution strategies and concessions that are available.

A brief summary follows:

1. Personal tax deductible contributions

Concessional contributions cap is $25,000 for all individuals.

If you are under age 67 you may be eligible to claim a tax deduction for making a personal contribution to your super fund of up to $25,000 in the current financial year. If you are an employee, your employer 9.5% Super Guarantee Contributions, super contributions paid on bonuses plus any salary sacrifice amounts to super, also count towards this cap. Where this applies, the available personal tax-deductible contribution will be limited to the difference between the $25,000 cap and the amount of the employer contributions.

Can you contribute to super after age 67?

If you are 67 years or over but no older than 75, you may also be eligible to make a concessional or non-concessional contribution if you either:

- Meet the work test (working 40 hours over 30 consecutive days in the relevant financial year); or
- Meet the work test exemption. Individuals between 67 and 74 in the first year of their retirement can make voluntary contributions into their super account without needing to satisfy the work test (the work test exemption). The relaxation of the work test rules only applies once and you cannot make contributions in subsequent financial years without meeting the work test. To qualify you must have had less than $300,000 in your super account at the end of the previous financial year.

2. Non-concessional (after-tax) contributions

Non-concessional contributions cap is $100,000 per individual subject to a $1.6m total super balance.

The standard non-concessional contribution limit is $100,000 p.a. for each individual as long as your total super balance (TSB) on the *last day of the previous financial year* (i.e. 30/6/2020) was *less than $1.6m*.

3. Bring forward non-concessional contributions cap

Under the bring forward rule, you can bring forward an additional two years worth of non-concessional contributions, allowing you to make a contribution of up to $300,000. Once you have triggered the bring forward rule (contributing more than $100,000 in any financial year), you have up to three years to utilise the bring forward cap. The cap is subject to your total super balance as follows:

Total super balance as at 30/06/2020	Bring forward NCC cap	Bring forward period
Less than $1.4m	$300,000	3 years
$1.4m to less than $1.5m	$200,000	2 years
$1.5m to less than $1.6m	$100,000	1 year
$1.6m or greater	Nil	N/A

The bring forward cap is age restricted and is not currently available to individuals aged 65 or over. It is expected that this will rise to age 67 in the near future.

4. Commencement of carry forward concessional contributions

Individuals can make catch-up concessional contributions into their super fund using their unused concessional contributions cap amounts from previous years. To qualify, individuals must have a Total Super Balance of less than $500,000 on 30 June of the previous financial year and must not have used all of their $25,000 annual concessional contributions cap in the previous financial year. Under the rules, individuals can carry-forward up to five years of unused concessional contributions caps for use in a later financial year, but the rolled forward amounts expire after five years. The five-year carry-forward period started on 1 July 2018, meaning FY21 is only the second year in which catch-up contributions can be made. If you are aged 67 or over, the normal work test rules apply.

5. First Home Super Saver (FHSS) scheme

The FHSS scheme allows you to save money for your first home inside your super fund. Contributions that count towards the scheme include voluntary concessional or non-concessional contributions so it does not include employer super guarantee contributions. You also cannot contribute more than allowable under the standard concessional and non-concessional caps. If you meet the eligibility criteria, you may be eligible to withdraw up to $30,000 ($15,000 of contributions made in any one financial year up to a total of $30,000 in contributions over all years) plus earnings on those contributions to assist with buying your first home.

6. Spouse Contributions Tax Offset

Maximum tax offset is $540.

You can claim up to a tax offset of $540 if you make a $3,000 after-tax super contribution for your spouse who has total income of less than $37,000[1]. The recipient spouse must be under age 75 and they must have a total super balance of less than $1.6m as at 30 June 2020 (immediately before the start of the FY21 year). The tax offset amount reduces when your spouse's income is greater than $37,000 and completely phases out when your spouse's income reaches $40,000.

7. Government Co-contribution

Maximum co-contribution entitlement is $500.

If you make a post-tax contribution of $1,000, the Government will make a co-contribution of $500 into your super account if your total income (earned as an employee[2]) is $39,837 or less. The co-contribution cuts out when your income exceeds $54,837. You must be less than 71 years of age and have a total super balance of less than $1.6m as at 30 June 2020.

8. Low Income Super Tax Offset

Maximum low income super tax offset (LISTO) is $500.

If your total income is $37,000 or less, you may be eligible for LISTO payment on the concessional contributions you or your employer makes. The Government will pay the maximum LISTO of $500 into your super account on a concessional contribution of $3,334, effectively reducing the tax on that contribution to nil.

9. Summary of changes from 1 July 2021

Due to indexation, there are a number of changes that will take effect from 1 July 2021:

- The concessional contributions cap will increase from $25,000 to $27,500
- The non-concessional contributions cap will increase from $100,000 to $110,000, which in turn will increase the amount that can be contributed under the 'bring forward' rule
- The general transfer balance cap will increase from $1.6 million to $1.7 million

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1. Total income is based on recipient spouse's assessable income, including reportable fringe benefits and salary sacrifice contributions.

2. You can also earn self-employment income or business income but it must be less than 10% of your total income, including reportable fringe benefits and reportable super contributions.

Making business *personal*

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