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FAMILY BUSINESS STRUCTURES

Rob Jeremiah FTIA

Harwood Andrews Lawyers

- Common structures for start up business and investments in businesses:
 - Discretionary trust
 - Company with shares owned by a **discretionary trust**
 - Unit trust

Snapshot of recent developments



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- *Bamford*
- TR 2010/3, trusts and unpaid present entitlements
- New streaming provisions & AAT decision in *Greenhatch*
- Proposed rewrite of Division 6
- Full Court decision in *Clark* to stand

Selecting a Structure – Key Considerations



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- Minimising income tax on business profits
- Flexibility in distributing income – family planning and access to corporate beneficiary
- Accessing CGT small business concessions on disposal of assets
- Raising new capital / introducing new investors

Selecting a Structure – Key Considerations



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- Retaining working capital to meet business' liquidity needs
- Asset protection
- Exiting the business
- Succession
- Restructuring

- Benefits
 - **Flexibility to distribute income** and capital to one or more members of the beneficiary class including persons, companies and trustees of other trusts
 - Tax planning to reduce overall tax burden
 - Preferred asset protection vehicle for families

- Shortcomings
 - **TR 2010/3** and restrictions on ability to retain working capital within business structure
 - Uncertainty of Division 6 rewrite and transitional position under Division 6E
 - Exit from business via sale of business assets only
 - Restrictions on raising new equity and attracting new investors
 - Fixed perpetuity period

- Asset protection
 - **Control** not ownership
 - Check that it is a 'pure' discretionary trust (hybrid variations could change nature of interest held by a beneficiary)
 - **Corporate trustee**
 - Joint appointors with an **independent person**
 - Limit business/investment activities of trustee

Discretionary Trust



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Trustee = Person A

Discretionary Trust



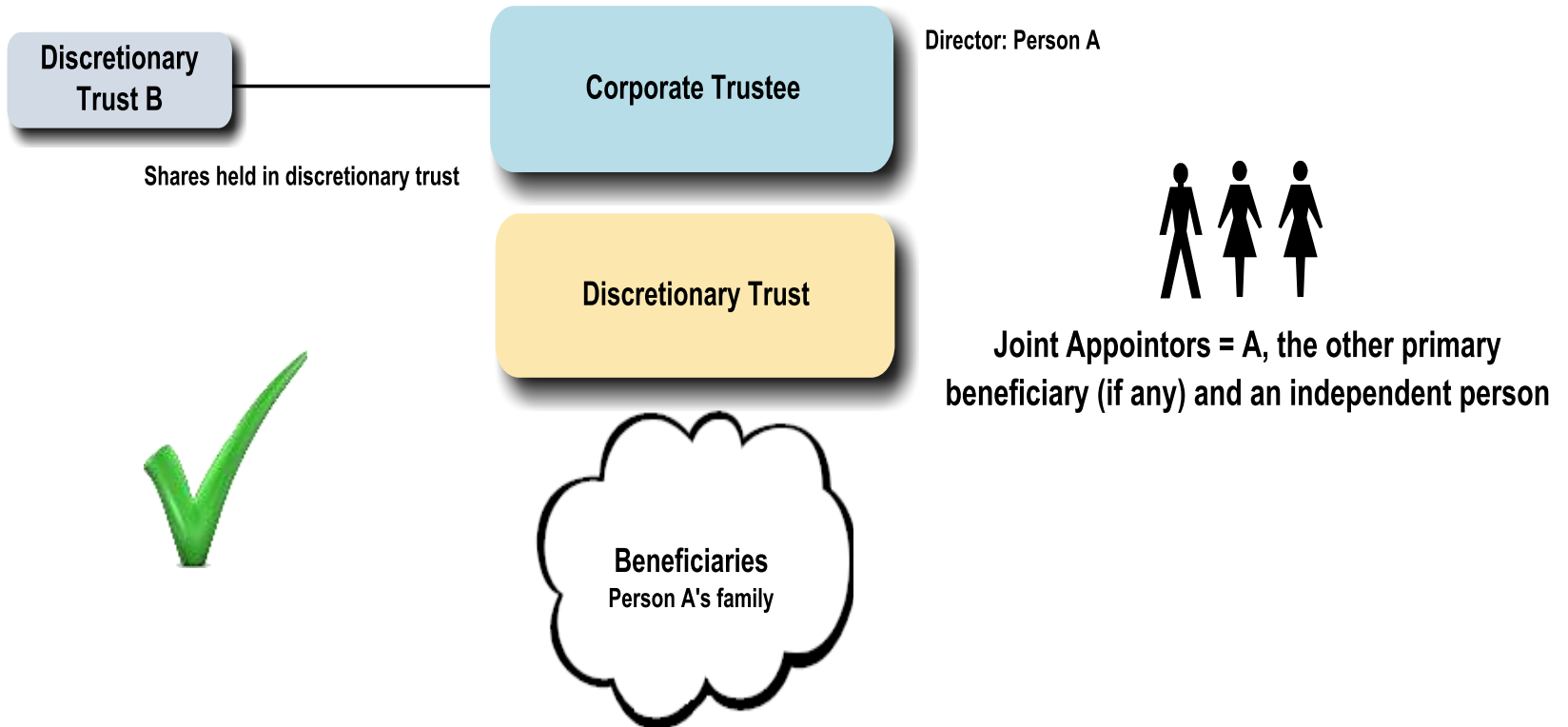
Appointor = Person A

Beneficiaries
Person A's family

Discretionary Trust



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- Exiting
 - Sale of business and business assets
 - CGT 50% discount – 12 month holding rule applies
 - CGT Small Business Concessions
 - 15-year exemption to disregard the **gross** capital gain in full; or
 - 50% active asset reduction to further reduce the 50% CGT discounted gain; and/or
 - Rollover to disregard the **discounted** capital gain; and/or
 - Retirement exemption to reduce the **discounted** capital gain.

- CGT Small Business Concessions
 - Relevant basic conditions
 - Aggregated turnover of less than \$2 million
 - Alternative to aggregated turnover test is maximum net asset value test of not more than \$6 million
 - Active asset test
 - Specific conditions apply in respect of the 15-year retirement exemption, 50% active asset reduction and the retirement exemption.

Discretionary Trust



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- Application of retirement exemption
 - Assume net capital gain of \$500,000.
 - Apply 50% discount and reduce net capital gain – once-discounted gain is \$250,000.
 - Apply 50% active asset reduction and reduce net capital gain by a further half – twice-discounted gain is \$125,000
 - Disregard \$125,000 by rollover exemption

- Application of retirement exemption (cont.)
 - Alternatively disregard by retirement exemption
 - Lifetime cap of \$500,000 for each CGT concession stakeholder
 - Requirement for choice and attribution of exempt amount to be made in writing
 - If stakeholder 55 or over - make payment (within prescribed timeframe) of capital proceeds to CGT concession stakeholder. If stakeholder under 55 – pay into superannuation fund of the stakeholder

- Succession
 - Passing on control
 - Provide for succession of appointor(s) and ownership/control of corporate trustee

Company owned by discretionary trust



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- Personal liability of directors
 - Personal guarantee given to repay company loan
 - Insolvent trading
 - Breach of Corporations Act duty
 - Transaction that reduces ability to pay employee entitlements
 - Director penalty notices

Company owned by discretionary trust(s)



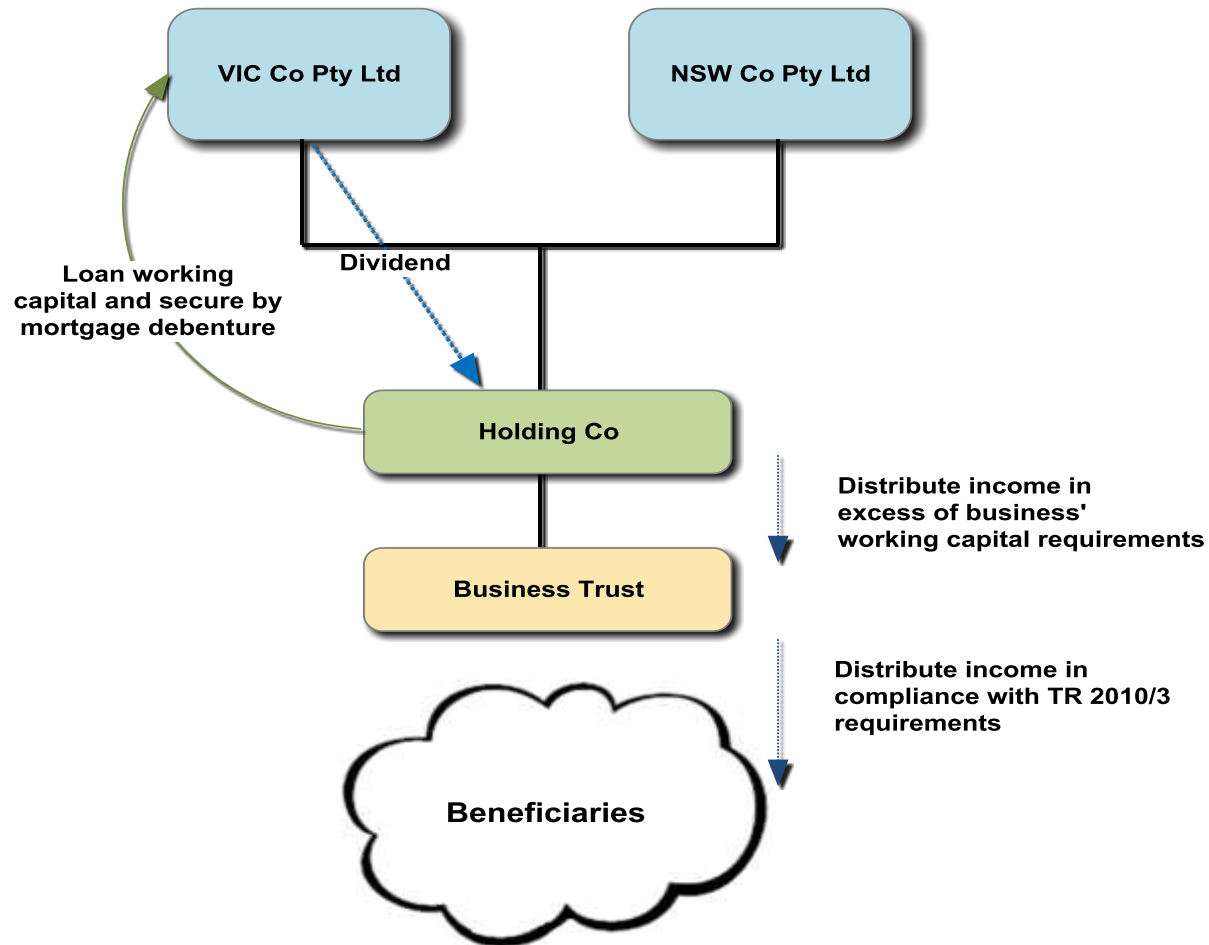
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- Benefits
 - Flexibility to distribute income
 - Raising capital by issuing shares or debt funding
 - Operating structure to suit the needs of the company
 - Election to consolidate
 - Retention of working capital
 - No perpetuity limitations

Company owned by discretionary trust(s)



- Retaining working capital within business structure

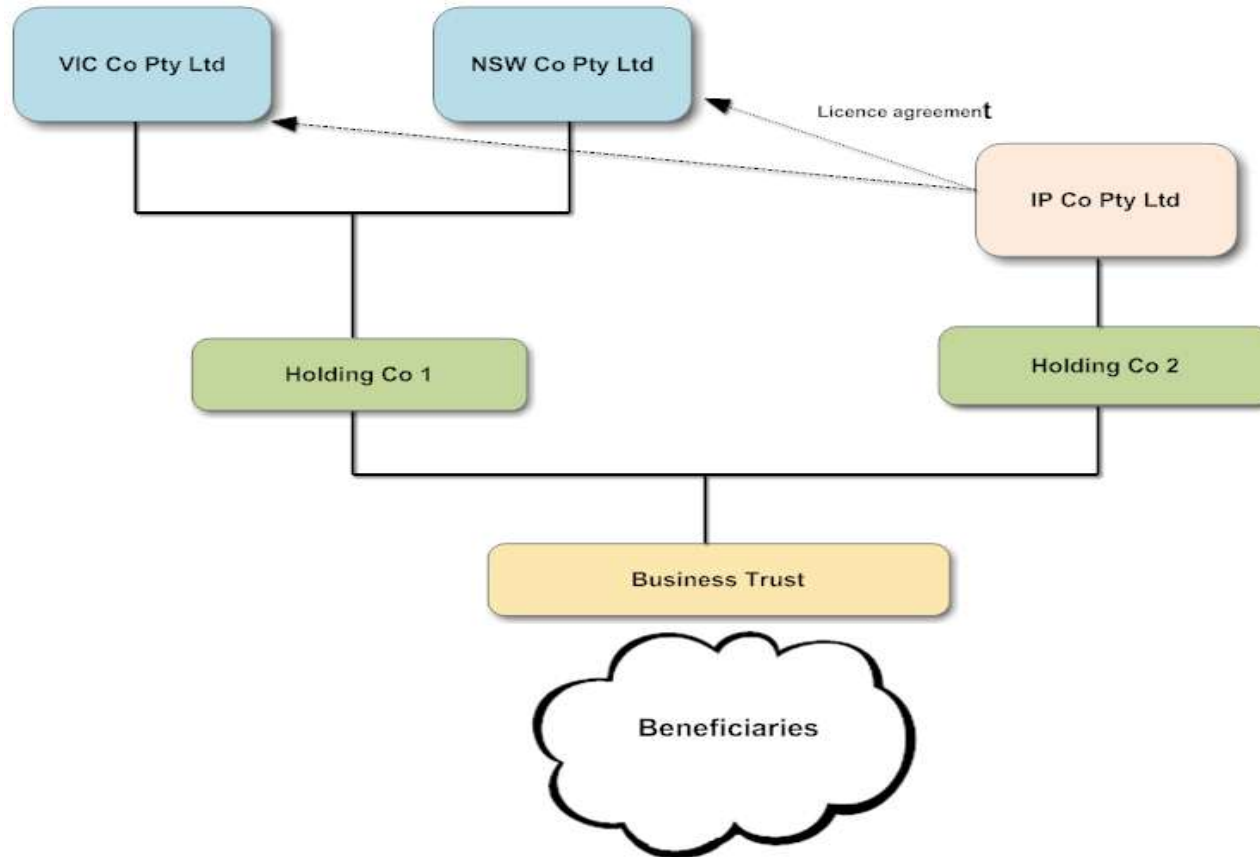


Company owned by discretionary trust(s)

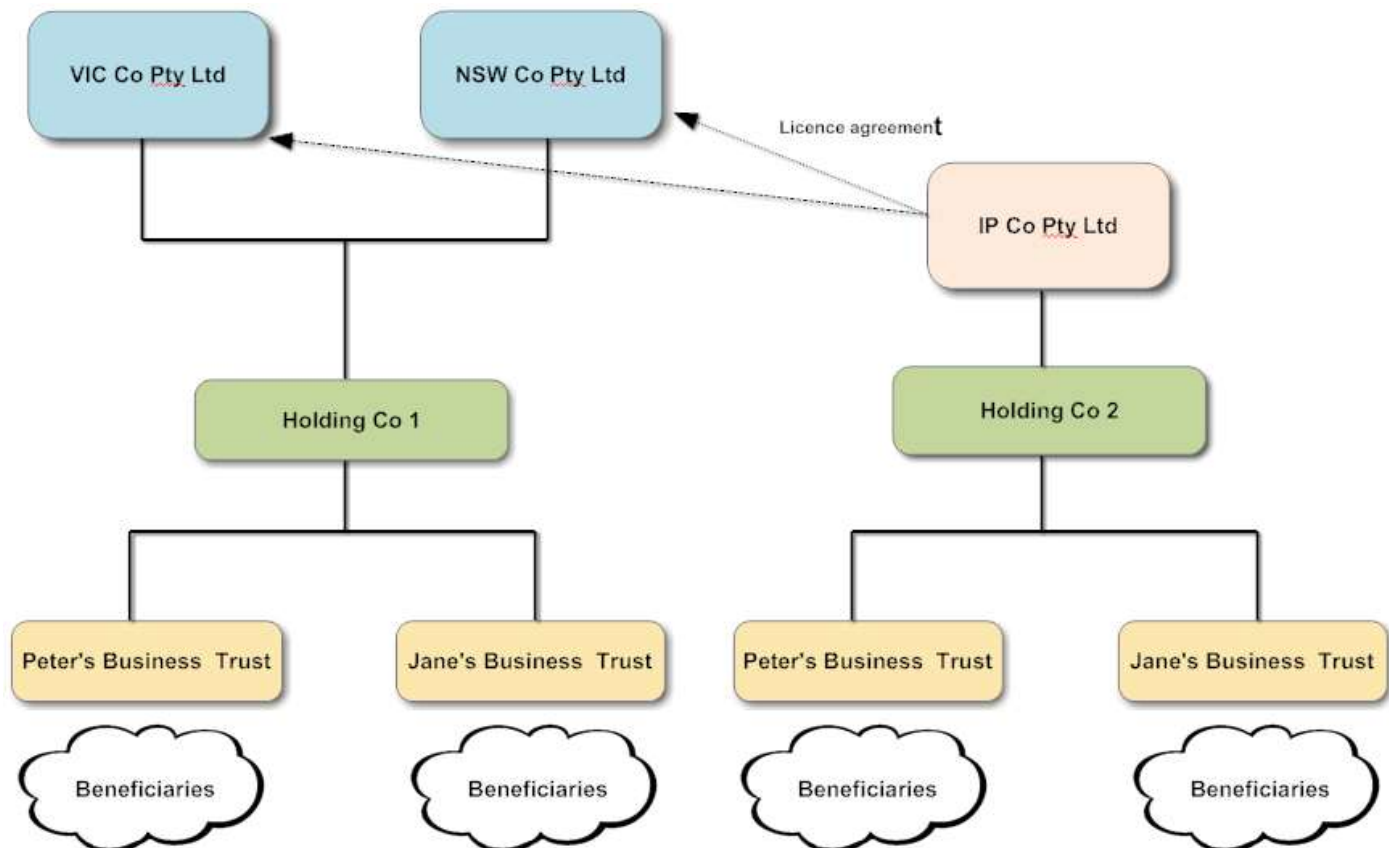


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- Single-family, multiple holding company structure



- Multiple families, multiple holding company structure



Company owned by discretionary trust(s)



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- Division 7A 'deemed dividends'
 - Deemed dividend to the extent that company confers an economic benefit on a shareholder or an associate of a shareholder:
 - Payment of cash (includes by way of credit)
 - Transfer of property
 - Granting of loan on uncommercial rates
 - Forgiveness of debt owed to company

Company owned by discretionary trust(s)



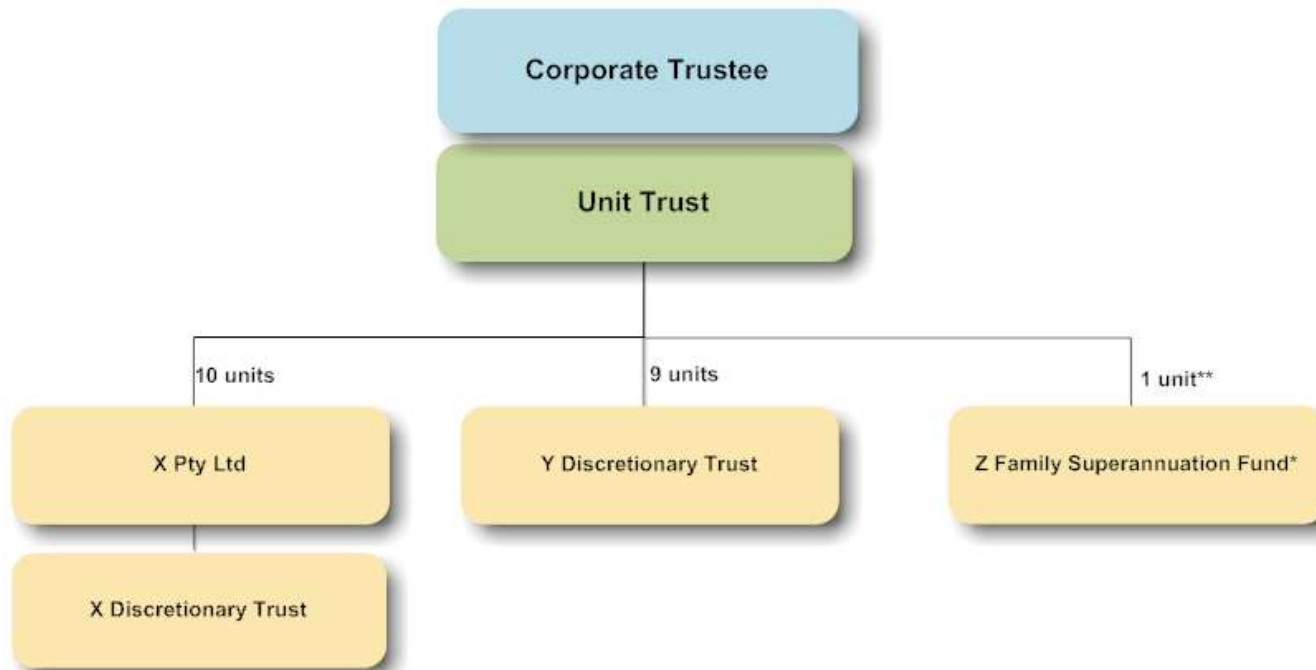
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- Exiting
 - Sale of shares
 - 50% discount available
 - CGT Small Business Concessions available if trust satisfies the maximum net asset value test, the active asset test and the small business participation test
 - Sale of business assets
 - 50% discount not available
 - CGT Small Business Concessions may be available if company and trust satisfy the relevant tests but note on liquidation clawback of 50% business active asset concession (CGT Event G1)

- Division of beneficial ownership of the trust fund into units
- Nature of interest of unit holder
- *CPT Custodian*
- Flexibility in respect of units:
 - Issue different classes of units (with different rights to capital, income and voting rights)
 - Units paid up to different extent
 - Different terms

- Investors
 - Discretionary trusts
 - Companies owned by discretionary trusts
 - Superannuation funds
 - In-house asset rules
 - Non-arm's length income rules (*Allens Asphalt case*)
 - Public unit trust rules

- Multiple families or investors



* ensure that investment does not breach SISA 'in house asset' rules and ITAA97 'non-arm's length income' rules

** superannuation fund should hold less than 20% of the units in the unit trust to ensure that the unit trust is not a public unit trust and taxed at the corporate rate

- Division 6 and Division 6E apply
- CGT events including CGT event E4
- Exiting
 - Sale of units
 - Sale of business

- CGT rollover concessions
- Value shifting rules
- Stamp duty

Our client, Vincent Kentridge, is in the process of setting up a new ownership structure for a business which is anticipated to operate in nationally.

It comprises a product and related services that will be marketed and sold in a number of discrete markets or sectors, for instance the construction industry, transport industry and health and medical industries. Each sector carries its own commercial risks.

The product is highly technical and involves considerable intellectual property; it is likely to generate a large amount of goodwill over time.

Case Study



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At this stage the business will be owner-operated by the founders. Our client is one of two founders, the other is his brother and life-long business associate Bob. Bob is the technology wizz and Vincent is the artistic and marketing brain.

Vincent tells you that he believes this product has huge potential – there might even be a global market and the potential for a stock exchange listing sometime down the track.

Vincent is married to Helen, his wife of 30 yrs. They have a son and a daughter of 15 and 19 respectively. His daughter, Kate, is in a serious relationship with Tucker, an obnoxious professional sports person agent many years her senior. Vincent is 57.

Bob is recently separated from his third wife. He has two children from his first marriage, June (17) and Raine (21). Bob's current girlfriend of 9 months is April. April is 26. Bob is 54.

Vincent and Bob have been successful in their earlier business ventures and will be able to fund the first year of operations through personal capital. However, they may need bridging finance prior to liquidating some of their current assets. Alternatively, they would be able to secure funding by way of secured loans through third party financial institutions.

Vincent has instructed us to advise him and Bob on establishing a suitable ownership structure. They, as with all clients would like the “holy grail” – a structure that allows for suitable growth, asset protection, minimal tax and ease of succession whilst providing them with control over the business.

As with most ownership structures, there will need to be a weighing up of the clients various requirements; a consideration of the factors: Which are considered fundamental and which are “nice to have”.

In our current situation factors which warrant consideration include:

- Ownership and Control
 - Deadlock between the brothers?
 - Keep each of Vincent/ Bob's personal structures separate
 - Current ownership entities

- The nature of the product and services, including:
 - The potential for growth, locally and internationally
 - Increasing IP value, with the potential that value will be attributed to goodwill
 - Where they will operate – different states potentially have different duty requirements
 - The discrete segments

- The Clients
 - Ages
 - Family Dynamics
 - Children (and their personal circumstances, such as for instance, in Kate's case her boyfriend; their ages etc.)
 - Current and former spouses or partners
 - Family Relationships
 - Between the brothers
 - Parent / children relationships
 - Between siblings and between cousins
 - Succession Requirements
 - Inheritance
 - Involvement in business
 - Wills

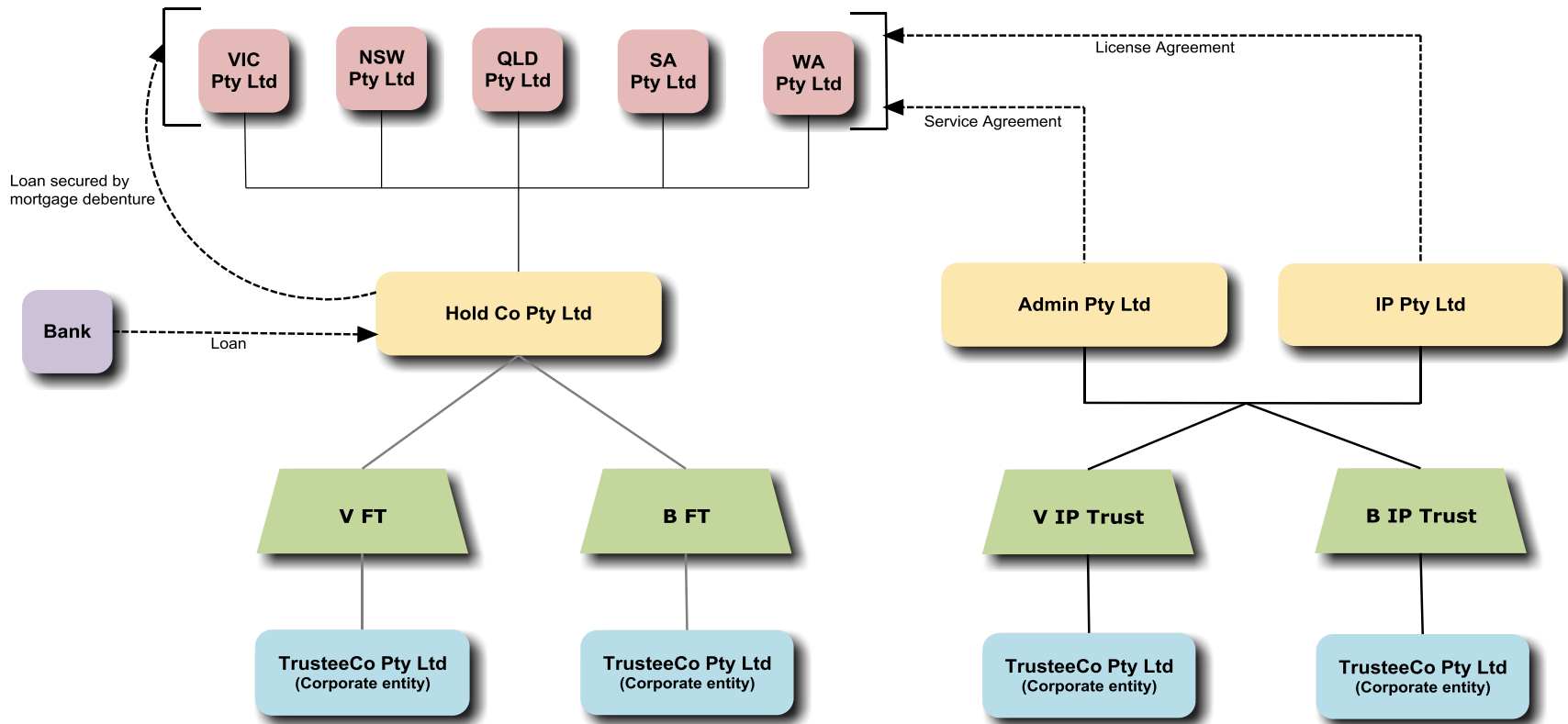
- Funding
 - Initial funding- bridging finance
 - Third party bank finance
 - Related party/ owner funding
 - Potential IPO and equity raising
- Tax
 - Business Income
 - Profit Distributions
 - Sale of business or interest in business
- Other
 - Asset protection – current and potential liabilities

What ownership structure is suitable? Is there type of entity that allows us to provide the required attributes?

Company and Trust Structures



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Company and Trust Structures



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Thank you for your attention.

Questions?