TAX TALKS

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61 | Structuring Business and Wealth

When structuring business and wealth there are a lot of moving parts. Especially when you throw tax into the mix.

Structuring Business and Wealth

But tax is just one part of the equation. There are many other factors to consider like asset protection or access to capital. But tax plays an important role nevertheless.

The other thing to remember in all this is that a structure might work well for you now. But might no longer do that later on. There is no size fits all. Business and wealth changes. And so does the optimal structure.

The good news is that a structure is not set in stone. You can change it.

It All Depends

How to optimise a structure very much depends on the nature, size and intended future of the business and wealth. It is difficult to generalise. It all depends on the individual circumstances of the case.

For example, a small business will often aim for three things. Access to the corporate rate tax, splitting of business profits across a family group and easy access to the small business CGT concessions.

But access to the corporate rate is only a temporaray benefit while profits stay in a company. Corporate tax is after all often just a withholding tax before you pay tax on the dividends on an individual level. If the business owner needs to access any profit straight away, it doesn’t matter whether there is a corporate tax rate somewhere in the mix or not.

The splitting of business profits is only of benefit when there are family members with low other income. If there aren’t, there is no point in splitting anywyay.

And the small business CGT concessions will be of no interest to you whatsoever when you already passed the maximum net asset value or turnover thresholds.

Asset Protection

Among many objectives, asset protection is often the #1 goal together with minimising tax. So before we focus on tax, let’s look at asset protection.

Asset protection is a noble cause but tricky. You can’t structure against all business risks. It is not possible to completely shield business operators from the ramifications of failure.

But there are some things you can do to protect valuable assets in case of insolvency.

The first thing is to keep valuable assets separate from day-to-day trading. Place them in a separate entity and then lease or licence them back to the trading entity. But to make this safe from creditors, clearly document the terms of the agreement and include a clause which permits the lessor/licensor to terminate the agreement in the event of insolvency.

The second thing is to avoid personal guarantees. Of course this is easier said than done. But there is little you can do to protect personal assets from personal guarantees. So avoid these whenever possible or reduce the extent of your personal assets.

Another common strategy to achieve asset protection is to have spouses and discretionary trusts hold the assets. And on paper this achieves the desired outcome. However, case law suggests that a well-resourced and highly motivated creditor can successfully work their way through these asset protection strategies to access the underlying assets.

Division 7A

Always keep Div 7A in mind when you consider a company . If you go for a company, you can access company funds through dividends or wages, but stay clear of company loans.

A company should be paid for any private use of company assets to avoid Div 7A. Or deal with private use through FBT if the private use is in respect of an individual’s employment.

If you use a bucket company, get the trust to actually pay any distribution to the bucket company. And make sure that any transfers of property to a company are at fair market value and not overpriced.

Section 100A

When you go for a trust, you can’t just distribute the funds to some but then actually pay the cash to somebody else. Section 100A puts an end to that.

s100A is about reimbursement agreement. It assesses a trustee (at the highest marginal rate of tax) on distributions of income to beneficiaries where someone else benefits from the distribution.

This could include circumstances where funds are on-lent by the beneficiary to another party. Or where funds are not physically distributed to the beneficiary as they have already been lent out to another person.

Section 100A only kicks in where the arrangement was entered into to obtain a taxation benefit.

So to avoid the Commissioner applying Section 100A, don’t say you distribute to A but then you actually pay the cash to B. Instead tmake the official distribution to the beneficiaries who actually receive the benefit of the distribution.

Trust Loss Provisions

For a typical discretionary trust the pattern of distribution test is the main hurdle for loss recoupment.

If a discretionary trust fails the pattern of distribution test, then the only option is to make a family trust election. With a family trust election the discreationary trust only needs to pass the income injection test.

CGT Discount vs Corporate Rate

Companies don’t qualify for the 50% CGT discount in Div 115, while individuals, trusts and super funds do. So that is a minus for companies.

But for that – and what is often neglected – companies have a much lower tax rate beyond a certrain level of income. And this lower tax rate is here and now while the 50% CGT discount might eventuate one day in the distant future.

So the decision to chase a future CGT discount needs to be balanced out against the initial top-up tax to fund the investment.

Restructuring

So you set up the structure. Many years pass. And now the structure no longer works for you. You want to restructure. There are a ton of rollover provisions that will allow you to do that without realising a capital gain.

 # 1 Subdiv 328-G

The first port of call for a restructure is Subdivision 328-G.

Subdivision 328-G is powerful in that it fully disregards all income tax consequences of a genuine restructure of an ongoing business, including impacts on trading stock and depreciable assets.

LCR 2016/3 provides some guidance as what the Commissioner considers is a genuine restructure of an ongoing business. But Subdivision 328-G is relatively new and there is little case law, so there is some uncertainty that requires caution.

 # 2 Subdivision 122-A

Subdivision 122-A allows an individual asset or all the assets of a business to be rolled over from an individual owner (or a trustee of a trust) to a new wholly-owned company.

The pre-CGT status of assets is maintained via the provision of pre-CGT shares. This rollover can apply to any CGT asset and not just business assets.

Subdivision 122-A does not apply to trading stock or depreciable assets, which need to be considered separately.

Subdivision 122-A is useful to break away from the limitations of trading trusts or where a business needs to raise capital or introduce a partner.

 # 3 Subdivision 122-B

Subdivision 122-B is essentially Subdivision 122-A but for partnerships. It likewise can apply to an individual asset or all the assets of a business.

 # Subdivision 124-M

The scrip-for-scrip rollover in Subdivision 124-M allows a company to acquire a target company by way of issuing shares, without crystallising a capital gain for the target company's shareholders.

This can be particularly useful for cleaning up a structure so that all relevant entities are part of the one wholly-owned group.

Subdivision 124-M equally applies to unit trusts, however noting that it is "like-for-like", that is, share for shares or units for units. It does not apply in situations where units are being swapped for shares (or vice-versa).

 # 5 Subdivision 615-A

What used to be the former Subdivision 124-G rollover, the new Subdivision 615-A rollover allows for the interposition of a new holding company in between an existing company or unit trust and its owners. Useful in situations where a client needs to start expanding their empire but needs a corporate group to do so.

6 Subdivision 124-E

Subdivision 124-E allows for a company to issue shares as consideration for it cancelling all shares in another share class. Useful for removing special classes of shares which are deemed to be no longer in the best interests of the company moving forward.

But there is a market value test, requiring the market value of the now cancelled shares to be equal to, or less than, the market value of the new shares issued.

7 Subdivision 124-N

There are undoubtedly circumstances where a unit trust was established for good reason, but now

the trust is a hinderance and should be a company going forward. Subdivision 124-N is the solution as it allows a unit trust to rollover all of its CGT assets to a new company which is owned directly by the unitholders.

8 Section 70-100

While of the aforementioned rollovers relate to CGT assets, an election under Section 70-100 operates to provide rollover relief for trading stock.

However, the application of this election is limited to circumstances where the original entity retains at least a 25% interest in the trading stock after the transfer. Accordingly, this election is only useful for admitting partners to an existing sole proprietorship or partnership.

9 Section 40-340

The final rollover that may be of use is the election available under section 40-340 which relates to depreciable assets.

The election will treat the transfer of depreciable assets to have taken place at adjustable value (ie written down value). The election needs to be in writing and signed by both entities.

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