INSTITUTE OF FINANCIAL PROFESSIONALS AUSTRALIA

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BUSINESS AND INVESTMENT STRUCTURING

Part 2- The Art of Business Structuring: Putting it all together and case study

Presented by

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Questions?

Please ask questions through the Q & A pod not on the chat pod.

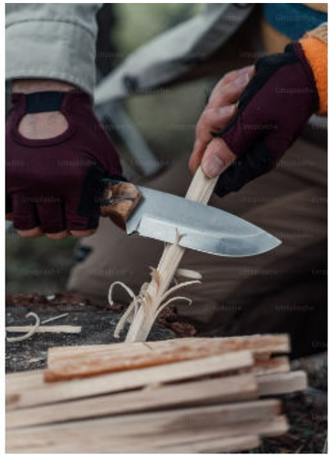
Not Answered Questions will be emailed to you along with the **webinar recording**

Tax efficiency

Considerations:

Tax rate

- 25% or 30%, or
- Could it be the top marginal rate?
- Note: companies create timing differences.
- Consider franking credits
- Could you make it a permanent difference if there is a year of lower income?



- ***Income splitting***
  - *Income vs capital (CGT discount?)*
  - *Use of family members, note s100A*
- ***Tax losses***
  - *Loss testing in company vs trust*
  - *Family trust election?*

Tax efficiency

Considerations:

Accessing cash and capital

- Trusts – flow-through entity
- Company – Division 7A

- *CGT concessions*
  - General 50% CGT discount
  - Small business CGT
- *Other considerations*
  - Land tax – trust surcharge
  - R&D concessions

Carrying on a business – what does it mean and why does it matter?

Eligibility for 50% discount is a key driver

What if the entity is eligible for the discount (e.g., trust, individual), but the entity is considered to be carrying on a business, *or* engaging in a profit making undertaking?

- *No discount!! Ouch.*
- *Implications (at a tax rate of 47%): 23.5% of the net proceeds are lost to tax.*
- *Even the best laid plans can fall down.*

- Indicia of a business (therefore holding 'trading stock'):
  - *The activity has a **significant commercial purpose or character**;*
  - *The taxpayer has **more than just an intention** to engage in business;*
  - *The taxpayer has a purpose of **profit** as well as a prospect of profit from the activity;*
  - *There is **repetition and regularity** of the activity;*
  - *The activity is of the same kind and carried on in a similar manner to that of the **ordinary trade** in that line of business;*
  - *The activity is planned, organised and carried on in a **business-like manner** such that it is directed at making a profit; and*
  - *The activity is not better described as a hobby, a form of recreation or a sporting activity.*
  - *The **size and scale** of the activities, although not determinative, are also relevant factors.*

Profit making undertaking / Greig's case

However – you don't need a business to have gains/losses on revenue account. Factors to consider:

(a) the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain; and

(b) the transaction was entered into, and the profit was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

*** Contrast – "mere realisation of a capital asset"*

Factors:

- *the nature of the entity undertaking the operation or transaction;*
- *the nature and scale of other activities undertaken by the taxpayer;*
- *the amount of money involved in the operation or transaction and the magnitude of the profit sought or obtained;*
- *the nature, scale and complexity of the operation or transaction;*
- *the manner in which the operation or transaction was entered into or carried out;*
- *the nature of any connection between the relevant taxpayer and any other party to the operation or transaction;*
- *if the transaction involves the acquisition and disposal of property, the nature of that property; and*
- *the timing of the transaction or the various steps in the transaction.*

Profit making undertaking / Greig's case

Greig's case:

- The taxpayer was a senior executive in the Bechtel Group. Between March 2012 and May 2014, he purchased 134,893,686 shares in Nexus Energy Ltd (Nexus) on 64 separate occasions for a total sum of $11,851,762.
- Active trader – short-term holding strategy
- In August 2014, Nexus' creditors approved a Deed of Company Arrangement (DOCA) under which all Nexus' shares were compulsorily transferred to the Seven Group for nil consideration.
- Made a loss of $11.8m + legal fees -> revenue or capital?
- Held: revenue account – more than "mere realisation of an asset" – why?
  - Very specific acquisition purpose
  - Purchased shares over 64 systematic transactions
  - Used his knowledge as Managing Director of Bechtel and relationship with Nexus CEO
  - Actively involved – engaged professionals, monitored analysts report, acquisitions designed to impact his influence on a sale, etc.
- What they couldn't successfully argue / contrast argument: "*an example of an ordinary investment engaged in by innumerable private investors each day*" (extract from single judge decision – overturned on appeal)
- What does this mean? Worked for him, but a signal to other taxpayers that they might not have the access to the CGT discount that they were hoping for.

Analysis of entity structures – tax efficiency

Tax Efficiency						
	Potential for top marginal tax rate	Distribution Flexibility	Easily Access Tax Losses	50% CGT Discount	CGT Small Business Concessions	R & D Concessions
Sole Trader	Yes	No	Yes	Yes	Yes	No
Partnership	Yes	No	Yes	Yes	Yes	No
Company	No	No	No	No	Yes	Yes
Discretionary Trust	Yes	Yes	No	Yes	Yes	No
Fixed Trust	Yes	No	No	Yes	Yes	No
Hybrid Trust	Yes	Yes	No	Yes	Yes	No

Analytical Conclusions

- No one size fits all
- Companies can be investment vehicles (CGT discount?) or corporate beneficiaries (not just trading entities)
- Think if the investment entity is carrying on a business of investment activities
- Think of the exit plan – is it saleable? Will a rationalisation be required?
- Don't plan to change the structure
- Discretionary trusts are very popular, but does 100A change that?
- Asset protection can be achieved in a number of ways
- The best outcome is probably more than 1 entity
- Caution against hybrid trusts
- Cost and complexity is an integral consideration to clients – people had compliance costs
- Don't rule out tax reform – minimum trust tax rate? Corporate entity rate change?
- What happens after death?

Case Study 1 (the property investor)

Client Profile:

- *High-net-worth individual*
- *Significant existing investment portfolio*
- *Desire to diversify into property investment*
- *Risk tolerance: Moderate*

Investment Goals:

- *Capital growth*
- *Income generation*
- *Tax efficiency*
- *Asset protection*

What structure would you advise? Is there any other information you would want to know, if so, why?

Case Study 1 (the property investor)

- Option 1: Individual Ownership:
  - *Pros: ease, CGT discount, main residence exemption if plans to move in to it?*
  - *Cons: personal liability, potential for top marginal tax rate*
- Option 2: Company Structure:
  - *Pros: Limited liability, timing benefits on sale (doesn't need to be flushed through)*
  - *Cons: loss of CGT discount, establishment and ongoing costs, potential for double taxation*
- Option 3: Trust Structure:
  - *Pros: CGT discount, asset protection, income splitting, flexibility in beneficiary distribution*
  - *Cons: Land tax surcharge, complex setup and administration, potential for higher costs (corporate trustee?)*
- What about a mix – e.g., trust and company?

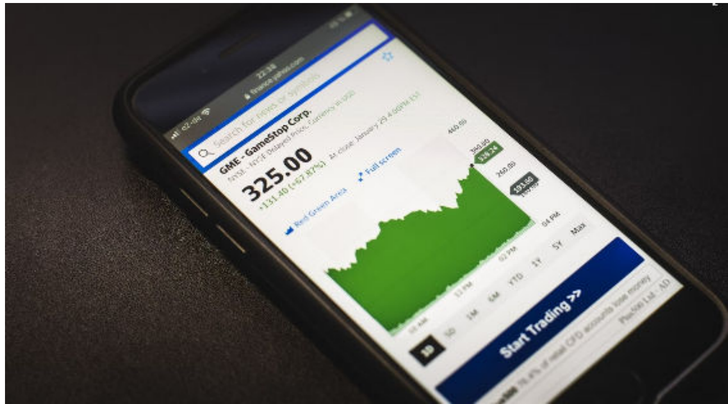
Case Study 2 (the share investor)

- **High-Net-Worth Individual:** Richard sells a business called Tamazon for $200 million cash and he hears that you are the finest wealth managers in the land. He engages your services.

- **Active Investor:** He is attracted to share investment. He will stay actively involved in his investments, be active in decision-making, and keep his own detailed records. He has written up his own investment strategy.

- **Investment Goals:** Capital growth, income generation, tax efficiency, and asset protection.

- He has not bought any shares yet, and has asked you how he should structure his investments. *For this example, you are not restricted in the advice you may give.*



Case Study 3 – Part 1/3

Frank is single man, who owns and runs an outdoor surf centre. He owns the site and is a sole trader. Frank also designs and sells his surf boards, for which he does a small amount of research and development. The business has had its ups and downs and he has incurred significant expenses. Given the amount of expenses incurred, Frank sometimes makes losses in an income year and has had some great profit years too. His average turnover is $7m per annum, and his business is valued at $2.2m.

What structure would you recommend for Frank?

- *Sole trader?*
- *Discretionary trust?*
- *Private company? If so, who should own the shares?*
- *Unit trust?*

Case Study 3 – Part 2/3

Frank tells you that he has been dating a lady, Michelle, and they are talking about moving in together. Michelle has two children aged 18 and 20, both at university. Frank gets on well with Michelle's children.

Does this change your analysis?

Case Study 3 – Part 2/3

Consider:

Income splitting

Division 7A

Cap the tax

Research and development (R&D)

Losses

CGT discount + small business CGT

Stamp duty

Land tax

Case Study – Part 3/3

One year later, Frank and Michelle are now married, and Frank wants his now brother in law, Tim, to join his business. The intention is to split profit and losses equally. They want your advice about whether they should:

a. *Form a partnership*

b. *Own 50% of shares in a private company individually*

c. *Own 50% of shares through their respective discretionary trusts*

d. *Own 50% of a partnership through their respective discretionary trusts*

e. *Own 50% of units each in a unit trust, through their respective discretionary trusts*

Discuss

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