Business Structuring

PART 1

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About the presenter

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Joshua Goldsmith is a multi-award winning lawyer and tax advisor - and is the managing director of JG Tax and Legal.

He provides tax and legal support to small and medium accounting practices on complex tax issues and ATO, SRO and TPB interactions.

JG Tax and Legal is a one stop shop for accountants and finance professionals and is rapidly expanding – it has recently introduced a Commercial Law division that provides support in relation to wills/estates, property transactions, buying and selling businesses and contracts (e.g., shareholder/partnership/unitholder agreements), entity formation (including trust deeds and constitutions) and family law.

Agenda

- **Setting the scene – post Budget**
- **Overview of entity options**
- **Companies**
  - Public vs private companies
  - Separate legal entity principle
  - Dividends, franking credits
  - Distribution or return of capital
  - Deemed dividends/Division 7A
- **Trusts**
  - Different types of trusts
  - Elements and key definitions
  - Beneficiaries and present entitlements
- **Partnerships**
- **Sole trader**
- **Things to consider when choosing an entity**
  - Main drivers
  - Other considerations

Introductory remarks

- Inherently complicated, and just got made a lot harder
- No one size fits all approach
- Restructure relief – think about setting up structures, and then restructuring post Budget
- The art in understanding your client *and* the art in asking the right questions
- ATO looks into restructuring – e..g, back to back rollovers (Anti avoidance provisions are tightening)
- Small business CGT worth a lot more post Budget.
- Today: entity options and key considerations on an entity by entity basis

Key items from the Budget

<u>Critical changes in the Budget</u>

Minimum tax on trust distributions for discretionary trusts

30% minimum tax on taxable income of discretionary trusts, payable by the trustee, from 1 July 2028.

Corporate beneficiaries specifically excluded from the credit mechanism.

Rollover relief proposed for three years from 1 July 2027

CGT changes

Removed 50% CGT discount and replaced with indexation

30% floor on capital gains

- Stamp duty (state tax). Particularly relevant in those states that do not exempt transfers of goodwill (e.g., Qld)
- Commercial agreements. Existing related-party loans, third party finance arrangements, leases, and employment arrangements will need to be renegotiated/updated to reflect the new structure - each with its own tax and legal implications.
- Family Trust Elections and Interposed Entity Elections. It remains to be seen how these would be dealt with by the rollover relief.
- Trust loss rules. Existing tax losses held in a discretionary trust are subject to specific utilisation tests and may not transfer into a new entity in a useable form.
- Back-to-back rollovers. Where assets need to pass through more than one entity, the interaction of rollover provisions becomes complex and can produce unintended CGT consequences. The Commissioner also looks unfavourably upon back-to-back rollovers, which we would expect will become very common in restructure activity.
- Estate planning. Restructuring often gives rise to estate planning considerations that should not be neglected. This is particularly relevant given the frequent use of trusts as an estate planning tool.

Rollovers – easy as that?

CONSIDER:

- **Stamp duty** (state tax). Particularly relevant in those states that do not exempt transfers of goodwill (e.g., Qld)
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Options overview

Trusts

- *Discretionary trust*
- *Fixed trust*
- *Hybrid trust*

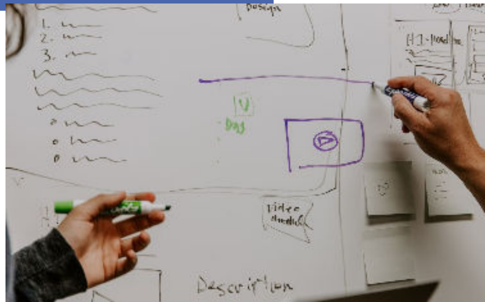
Companies. *Expect these to be much more common now!*

Sole trader

Partnership

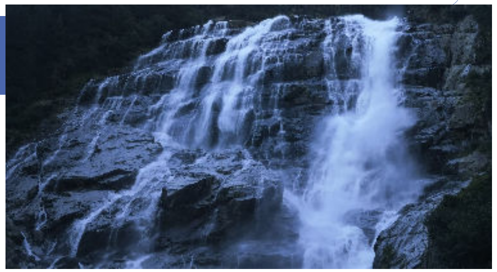
Company

- Public vs private companies – *follow the law*. Why it matters? Div 7A
- **Separate legal entity principle** – *heard about the LA highway case?*
- Getting money out of a company – *dividends vs returns of capital (consider share capital account)*
- Meaning of a dividend – *distribution or an amounted credited; out of profits; taxable on income account*
- **Franking credits** – *credit for corporate tax paid (nb: franking account balances; top up tax)*
- **Corporate tax rate** – *25% or 30% -> high!*
- Withholding tax
- Distributions of capital – *consider CGT. Know the difference between CGT and income tax?*
- **Deemed dividends / Division 7A** – h*ow and why it operates. Need to know this for cash flow management.*
- Aus: now a terrible system for taxing capital, but a brilliant system for Aus sourced dividends
- The rise of investment companies. Here they come…



Trusts

- Fixed trusts vs unit trusts vs discretionary trusts. Matters a lot now – 30% minimum tax not applying to fixed trusts. Expect the rise…
- Characteristics of a trusts: trustee, trust property, beneficiary(/ies), fiduciary obligation
- Express trusts – essential principles: certainty of intention to create the trust, subject matter (assets), objects (beneficiaries), requirement in writing, vesting
- Definitions: appointor (‘Chairman’), trustee (‘CEO’), settlor, bare trust
- Present entitlement (indefeasible, vested interest – doesn’t even have to be aware!)
- What if no beneficiary is presently entitled to an amount of income? – *Uh oh! Trustee tax or default beneficiaries*
- UPEs
- 100A – *the game has changed!*
- The bucket company – surely they can’t be serious…
- Does *Bendel* even matter?



Partnerships

Takes many forms – e.g. individuals, trusts or companies

Essential elements of a partnership at law:

a valid agreement between the parties (whether formal or implied);

the carrying on of a business;

the carrying on of a business in common (i.e. each partner acts as the agent of the other partners, and is jointly and severally liable for the debts of the partnership);

a view to profit.

Tax law partnership – 2 types

an association of persons **carrying on business** as partners; and

an association of persons **in receipt of** ordinary **income** or statutory income **jointly**.

Sole Trader

Base model

No separate entity

Cheapest, most simple, but obvious limitations

- *Can’t cap rate of tax*
- *No asset protection*

Ultimate convenience though

Consider: investing in spouse name (lower income earner)

What to think about when choosing an entity

Main drivers:

- *Income tax*
- *Asset protection*
- *Estate and succession planning*

What to think about when choosing an entity

Other Considerations

- Cost
- Complexity
- Sustainability to float
- Ability to capital raise / introduce new owners
- Working capital
- FBT
- Payroll tax and Workcover
- Multiple entities
- Stamp Duty
- Land Tax

Legal considerations

These are often the single most important pieces of the puzzle, and often given the least amount of thought

- Consider estate planning. New structures may require a review of Estate plan
  - E.g., succession clauses
  - What does the deed say? What does the constitution say?
  - Is each entity aligned?
  - Does the family actually know what is going to happen with the entities controlled by the relevant individual?
  - *We are familiar with group structures, but DO NOT leave behind a mess*
  - Trusts have always been a great way to transfer control – they may still have a place for this reason alone
- Shareholder / unit holder / partnership / co-ownership agreements – *hope for the best, expect the worst*
  - This ties it all together when independent parties are involved
- Family agreements – e.g., Binding Financial Agreements (formerly known as pre-nups)
  - Do they deal with the entities in the control of the individuals?
  - E.g., not dealing with the assets of a discretionary trust in the control of the parties is a big miss…
  - The drafter of the BFA often does not know / get all the relevant information. *They need their trusted advisor to help them think of all relevant points.*

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