

### Business and investment structuring post-budget

Deciding on the optimal business structure to operate through, or to hold investments in, has always been a complex exercise. There is no magic formula or 'one size fits all' approach as every person is different and has different objectives. A good adviser needs to have a sound understanding of the commercial and practical features of different entity structures and have access to tax expertise.

This article looks at the key criteria that should be analysed and discusses the impact of the 2006 Budget.

#### *Tax savings versus asset protection*

Clients need to be made aware that tax efficiency (ie, legitimately saving tax), although important, is but one part of the jigsaw puzzle.

For example, the benefits of negative gearing can only be directly accessed where a rental property or shares for example, are held in an individual or individuals' names. However, by holding assets in personal names those assets are at risk of forfeiture in the event of litigation or bankruptcy.

Depending on the risk profile of the client, it may be generally better to forgo the direct negative gearing benefit (ie, offsetting a rental loss against the tax on a high personal income) and achieve asset protection by using a discretionary trust to borrow and acquire the assets.

With care taken, the discretionary trust will be able to deduct revenue losses to be offset against current or future trust income and the client will enjoy the other features of a discretionary trust — such as the ability to split income amongst beneficiaries, stream particular types of income (including capital gains) to particular beneficiaries and for the beneficiaries to apply the 50% general capital gains tax ('CGT') discount in their own hands.

#### *Other Considerations*

Although tax efficiency and asset protection are the two main criteria to assess, there are a range of other factors which need to be analysed. Some of these are the annual regulatory and accounting costs, whether any CGT rollover relief exists to change the structure in the future, the complexity of the structure and how it is perceived by the participants and

parties who deal with the structure and whether succession to the next generation can be achieved without adverse tax consequences.

Also, State taxes must be considered such as payroll tax, stamp duty and land tax. For example, in NSW and Victoria higher rates of land tax apply to trustees that own land.

Complying superannuation funds are a perfect example of where understanding the regulatory restrictions is just as important as ensuring that the available taxation benefits are maximised.

Also, for particular professions the available structures allowed under the State Acts that regulate these professions must also be considered.

#### *Is there an ideal business structure?*

Broadly, a popular structure is still a discretionary trust with a corporate trustee (for a single family) or a partnership of discretionary trusts for multiple families. In some cases a hybrid class unit trust is used for property holdings or developments with multiple families involved but care must be taken as there are some unexpected problems with this type of non-fixed trust. If these are not possible or acceptable for whatever reason then a unit trust owned by multiple discretionary trusts is also a popular alternative.

**BUY-SELL AGREEMENTS:** Remember when structuring a business with multiple owners, ensure a formal agreement is in place regarding what happens if one party dies, wants to sell, etc. This is a vital step. For more information about such agreements, visit [www.dbabutler.com.au/index.php?p=BSA](http://www.dbabutler.com.au/index.php?p=BSA)

#### *2006 Budget*

Under the existing CGT small business concessions there is a problem with satisfying certain tests where unitholders or shareholders are not human beings but instead are other companies or trusts (ie, the 'controlling individual' test). This has been one of the reasons why partnerships of discretionary trusts have been popular due to each discretionary trust, in effect, applying the tests in isolation.

The 2006 Budget includes proposals to amend these CGT rules to allow tracing through multi-tiered structures to see if a 'significant individual', broadly, holds at least a 20% interest in the entity which ultimately holds and conducts the business.

Unfortunately, the devil is in the detail with these proposed changes (not released to the public at this stage) and we understand that the outcome will depend on whether there is an asset/business sale or a sale of shares or units.

Also, with the 2006 Budget's further reduction of personal marginal tax rates and the already existing anti-avoidance rules which apply to persons using companies to derive their personal services income, it is expected that private companies will continue to remain the least favourable structure for small businesses.

These and other changes are simply another planning opportunity to carefully assess for clients proposing to establish, restructure or acquire a business. It is the role of advisers to make sure that clients are informed of all the pros and cons of a particular structure.

In planning today there is no absolute certainty as to the future. Experienced advisers, however, keep on top of change undertaking regular reviews of each client's structure.

If you would like to discuss structuring a business or investment, please contact Marco Saccotelli ([msaccotelli@dbabutler.com.au](mailto:msaccotelli@dbabutler.com.au)) who heads DBA Butler's tax and commercial law division.

## New ATO ID undermines afforestation arrangements

Many people have invested in afforestation arrangements (ie, land and a management contract where a promoter tends to trees on the land). Often an upfront deduction is claimed in an individual's name and in some cases the investment is then transferred to the individual's SMSF. This relies upon the investment being viewed as business real property ('BRP') and thus not breaching s 66 of the SISA (ie, the prohibition on acquisition of assets from related parties with certain exceptions, such as BRP). ATO ID 2002/987 provided support for this view.

However, ATO ID 2002/987 has been overturned by ATO ID 2006/261. The interest in the afforestation arrangement may well now be viewed as BRP *plus* the bundle of rights associated with the management contract. Accordingly, the investment *as a whole* is not BRP and transferring the investment to an SMSF might breach s 66. This should also be borne in mind when considering other transactions involving BRP. SMSF trustees must now be far more careful when acquiring BRP with attached contracts (eg, a property manager).

Those whose SMSFs have engaged in such arrangements should seek advice to ensure they are not at risk.

## SMSF & ESTATE PLANNING REPORT

The Report is a 30+ page publication, fully up to date as at 25 September 2006.

The Report provides up to date information on important legal questions regarding SMSFs and death. In addition to flagging vital considerations and containing handy diagrams and checklists, the Report outlines what happens to SMSFs upon death and discusses tax implications and strategies.

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for 2006  
Budget!**

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