
**BUSINESS PLANNING,
STRUCTURING ,
TAXATION AND
CAPITAL GAINS TAX
CONSEQUENCES**

No business is able to succeed, or even survive, purely by luck. The future is uncertain. business survival depends largely on how you react to it. Only by planning can you react positively. The growth and management of assets is ever present in all our minds and daily activity. Regardless of the asset path you embark upon, the facts which remain constant are:

- the conversion process from remuneration cash flow to capital growth must pass through the “tax filter”;
- the appropriate “financial structure” will improve the overall return of an investment; and
- the correlation of risk and investment yield is directly proportional to each other.

The business owner is forever assessing tax advantages, disadvantages, investment risk and investment return; however, often ignoring the development of an appropriate business structure which is able to provide a platform of future flexibility and improve the conversion efficiency from remuneration into after tax dollars.

The conversion process of pre-tax cash flow into capital growth or debt reduction has direct relationship with wealth and very often wealth growth is inhibited by inappropriate financial structures.

ESSENTIAL ELEMENTS

There are three essential elements to business planning which influence any business:

- The existing business structure;
- Identifying and minimising risk and uncertainty;
- Creating a strong base for prevention and future growth;

Often a business structure has been adopted for historical reasons. Such a structure may not remain appropriate over a period of time. Any business structure requires periodic and careful review. Your business structure should be flexible, understandable and economical. Each of these will vary by degree according to the scale and complexity of your business. The 70s were the era of companies, 80s trusts, 90s superannuation funds. Asset protection and tax minimisation are the two most praised virtues of family trusts, although experts differ on which attributes figures most heavily in the minds of those who set up trusts.

With the shelving of the Government's plan to tax them as Companies, the tax benefits of Trusts remain. Trusts allow the streaming of income to different family members. Beneficiaries age 18 or more each get the tax free threshold, and when the family unit is viewed as a whole, the tax impost is greatly reduced.

IDENTIFYING TRIGGER EVENTS

As a result of the tax changes and the adverse bankruptcy rules, cross ownership of business equity insurance, very common in the early 1990s, is now rarely used and many existing policy ownership arrangements have or need to be changed to accommodate self and related insurance. Other changes such as:

- The use of Testamentary Trusts in Wills, with their ability to generate excepted (concessionally taxed) income for minors;
- The abolition of Death Duties;
- The increasing proportion of domestic relationships ending in divorce or permanent separation, and;
- The use of superannuation ownership;

The business structure cannot be considered in isolation. It must be looked at in the context of your family structure. In your own circumstances your business should provide flexibility for income tax planning and future capital gains tax liability and growth of the business asset protection and retirement planning. Efforts should be made to minimise risk and exposures for your business in its daily activities and also for you and your family members.

Only by identifying whether sole trader, partnership, company or trust arrangements are appropriate can you determine in whose name assets should be acquired and liabilities incurred. Often it becomes impracticable to restructure a business quickly because of the costs of transferring assets and redirecting liabilities. This emphasises the importance of recognising the most appropriate structure and working towards implementing a plan over time. In some circumstances, a review may be as simple as identifying in whose name future business and private assets are acquired or in whose name future liabilities are incurred.

BUSINESS SUCCESSION

Identifying and minimising risk and uncertainty involves the often neglected area of business succession planning. Put simply, this is a matter of identifying events which may cause instability to your business and establishing a contingency plan should any of those events occur. These events could include death or incapacity of a partner and/or marital break up leading to voluntary retirement/resignation and/or forced retirements and/or other factors important to your business.

This form of plan should be reduced to a written agreement to ensure that your stated intentions become legally binding on you and your partner/s and any related parties who later may not share your views. In this sense a Business Continuation Agreement should be insurance against dispute and consequence expense and trauma.

An agreement should not only identify trigger events, but also:

- Establish a right to buy/sell a business interest;
- Establish a means of funding the purchase/sale;
- Identify an appropriate valuation process;
- Incorporate a mediation/dispute procedure;
- Encompass expected duties and responsibilities and basis of exit, contribution and remuneration.

Personal estate planning is often neglected but so much of our hard won wealth can be lost by a lack of effective planning. The first step is to identify what is owned and what is not.

Jointly Owned Assets

Jointly owned assets will generally not form part of your personal estate. Their ownership will pass automatically to a surviving joint owner on death irrespective of the terms of any will. However, consideration should be given to determine to whom the property will pass if you are the surviving joint owner. Thus the second to die succession can trigger a capital gains tax liability, which is in fact a de facto death duty.

Trust Assets

Assets held by any business or family trust belong to the trust and do not form a part of your personal estate. It is essential that a will is made for the trust to help ensure that the trust assets are ultimately distributed in the manner contemplated by you rather than simply left to chance. This should be done immediately.

Company Assets

Any company assets remain the property of the company. As a shareholder you only have a right to receive any dividend from the shares and have an expectation of receiving proceeds if and when the company is liquidated. So only the shares themselves form part of your personal estate, not company assets.

Life Insurance & Superannuation

Entitlements

It might be thought that very few assets actually form part of your personal estate. However, life insurance and superannuation entitlements, which may be paid on death, incapacity or retirement, often form a substantial part of any personal estate. These monies together with any personally owned assets deserve careful consideration in your will.

Will Trusts

The Tax Office has always recognised that income derived from a trust established by a will deserves special treatment. These types of trust arrangements are known as 'testamentary trusts'. A well drawn will can provide great flexibility. This may be best explained by way of example.

Consider a person who has established an effective business plan and family structure. Many assets may be retained in a family trust. However, on an unexpected death, life insurance and superannuation proceeds may be received and result in a substantial estate.

If the estate is left entirely to the surviving widow/er or other preferred beneficiaries the income earned on the estate entitlement could be subject to considerable income tax. A death in the family is difficult and expensive enough without losing a substantial amount of the estate proceeds to taxation.

Income Tax Benefits

If the person has a tax effective will the estate proceeds can be distributed in the preferred priority and/or proportions to one or more testamentary trust established by the will. In the case of a person leaving a spouse and children the income derived from the estate proceeds can be allocated to the spouse and the children and taxed as if all of them were adults. Children are normally entitled to earn a little over \$600.00 investment income per year before tax becomes payable at penalty rates (currently 67.7%). In the case of children under the age of 18 years deriving income from a will trust, they would each be entitled to receive \$6,143.00 income per year before paying any tax. Any additional income derived from the testamentary arrangement would be taxed at normal adult rates. At the very least, this could provide more than \$6,143.00 tax free income to each child which could be applied by the surviving spouse to help meet the needs of bringing up the children without the deceased person.

Capital Gains Tax Flexibility

The testamentary trust arrangement can be used to a similar advantage for distributing any capital gains tax liability realised by the trust estate. In the absence of any other income a child could have up to \$25,000 worth of capital gains distributed by the testamentary trust each year without incurring any tax liability.

A separate testamentary trust could be established for each intended beneficiary. Subject to any limitations which might be imposed on the different beneficiaries, a well drawn will would allow the beneficiary to draw out capital as well as income if circumstances required.

In the case of spendthrift beneficiaries and/or infant beneficiaries, independent trustees could be appointed to administer the trust funds and supervise how and when monies are to be spent.

Protection from Creditors

In the case of a beneficiary in a risk occupation or in a financially threatened position, any funds held in a testamentary trust arrangement could be protected from the demands of creditors or a trustee in bankruptcy. These aspects may be particularly important, not just in your own will, but also in the will of any surviving parents or other family members. As a potential beneficiary of a will of a parent or other benefactor, you and your family could benefit directly from tax effective estate planning.

Establishing a Business Plan is a critical step for any business and should be adopted as an ongoing process which is reviewed regularly. Any effective business plan should involve the talents of experienced professional advisers in legal, taxation, accounting, insurance, financial planning, human resource and strategy fields. In turn, any business plan can only be regarded as part of an overall succession plan involving both personal business, family and other related interests. An overall review is essential to help achieve the objectives of:

1. Confirming and implementing and appropriate business structure.
2. Identifying and minimising risk and uncertainty.
3. Creating a strong basis of wealth preservation and future growth.

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