

## Tax Solutions for SME's

Further to our discussion recently please find an overview of the Business Structures for SME's. The key to building a successful new business may reside in the duality of being up to speed with the latest technology within an environment of old fashioned company values. The Pearson Partners team credits a large proportion of the company's success to having a clear, straightforward proposition and 'referenceable' customers. We also recommend the following principles for would-be self starters.

1. Focus on revenue! No company can survive without sufficient cash flow and steady profits. Watch your outlay and don't indulge in a fancy office or expensive toys- at least initially.
2. Develop a detailed and focused business plan for the next one to five years, taking into account how you want the company to evolve over the long term. Put in place a strong, experienced management team.
3. Recognise your niche and build on your Unique Selling Point (USP) Work with investors who: a) add value to your business; b) are large enough to get involved in further rounds of financing if required ; and c) have good experience with similar technologies.
4. Never forget the importance of outstanding customer service . It's harder to attract new customers than it is to garner repeat business.

The following overview will assist you in the integration of your operations , property investments and financial assets.

1. Introduction
2. Discretionary Trust – The basic structure for maximum CGT and Income Tax efficacy
3. Structuring to negatively gear
4. The advantages and disadvantages of a Discretionary Trust to access CGT concessions
5. Using a Company owned by a Discretionary Trust or Trusts
6. Holding CGT assets separate to the business
7. Using a Partnership of Discretionary Trusts
8. Discretionary Trust owning a Unit Trust
9. Partnership or Company for personal service income
10. Summary

## 1. INTRODUCTION

There will be a number of determinative factors that will contribute to the ultimate choice of a business structure e.g. :-

- **Asset Protection, Estate Planning and Succession Planning**

The discretionary trust has traditionally been the preferred vehicle to achieve both asset protection and a seamless allocation of assets amongst family members as part of a succession plan. A company will also provide asset protection but is somewhat inflexible when it comes to asset allocation.

One has to be cognisant of the relevant Bankruptcy legislation when settling a trust for asset protection purposes if it can be interpreted as part of an arrangement to avoid creditors. Asset protection is usually the primary counter to the PTIVA argument that the trust's dominant purpose was to obtain a tax benefit. It is worth noting that asset protection is effectively achieved through the granting of a power of appointment to a family member which will have the effect of preventing the trustee in bankruptcy taking over a corporate trustee and appointing himself a director where the bankrupt is a family member and controls the trustee.

- **Access to cash**

The preference for the receipt of a dividend or a trust distribution will need to be taken into account. With the introduction of a regime allowing for the refund of excess franking credits, the choice between company and trust has narrowed in the case where a beneficiary/shareholder is able to take advantage of a tax rate below 30%. Access to loan funds will also be an issue. Generally because Divn 7A has no application to trusts (with the exception of s 109UB<sup>1</sup>), loan funds can be drawn from trusts on more flexible terms e.g. interest free and or extended repayment dates.

- **Access to the 30% Tax Rate**

Notwithstanding that a company provides ready access to the 30% tax rate, a trust can also provide such access through the use of a corporate beneficiary.

---

<sup>1</sup> The government has announced that it will replace section 109UB of the Income Tax Assessment act 1936 with a new set of rules effective from 12 December 2002. At the time of preparation of this paper the Treasury has issued draft legislation for comment to the professional bodies. Accordingly, the tax effectiveness of the strategies involving trusts that are discussed in this paper will depend on the final form of that legislation.

Care must be taken to avoid borrowings by associates of shareholders, where the trustee has not paid the amount to the beneficiary, after the corporate beneficiary has become presently entitled to the income of the trust estate to avoid such borrowing being deemed a loan by the company to the associate (s109UB<sup>1</sup>). Such loans cannot be excluded from s109D (which deems loans to be dividends) by the operation of s109M or N which exclude certain loans from the deeming provision of s109D if they meet certain minimum annual repayment criteria and interest rates or the company is in the business of making loans and the loans to associates are made on the same terms as they are made to members of the public. The simple explanation for this is the Act cannot prescribe repayment criteria to a deemed loan i.e. one that doesn't exist.

- **Tax Preferences**

Discretionary and hybrid trusts along with sole proprietors and partnerships of individuals have the ability to retain tax preferences either directly or for the benefit of their beneficiaries.

Beneficiaries of fixed trusts are not required to make cost base adjustments when they receive non-assessable amounts associated with the 50% capital gains tax discount, but they are required to make cost base adjustments when they receive non assessable amounts associated with building allowances (capital works deductions) and the small business CGT concessions.

- **Streaming**

Discretionary and hybrid trusts effectively allow the streaming of income and capital to selected beneficiaries without the restriction of anti streaming rules as they apply to companies (ss45 and 45A) and the franking credit streaming rules (s160AQCBA/s204-30).

- **Roll Over Concessions**

With the exception of the subdivision 122-A roll over (trust to company with the shares held on the same trust) and certain unit trust roll overs to a company (subdivision 124-H,124-N) these provisions only apply to companies.

- **Group Concessions**

These concessions are only available to companies.

---

Consolidations generally only available to companies. A head entity must be a company although a fixed trust can be a member if wholly owned by a group member.

CGT discount.

Available to individuals and trusts, not available to companies.

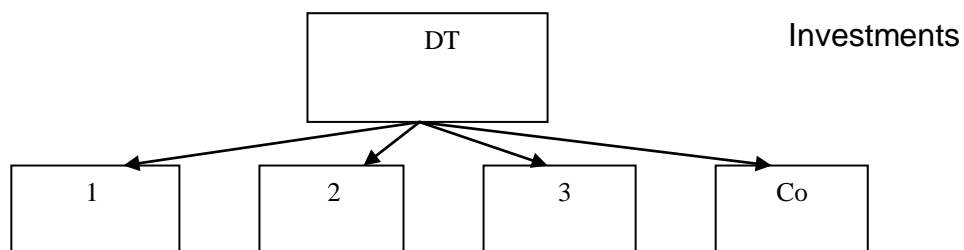
- **Partnership of Trusts**

A partnership is treated as transparent from an income tax point of view. Partners can run their own income tax position. Losses are allocated directly and upon sale each partner can pursue a separate entitlement to CGT discount and small business CGT concessions. However, there are genuine CGT difficulties when changes in the composition of equity occur.

## 2. **DISCRETIONARY TRUST – THE BASIC STRUCTURE FOR MAXIMUM CGT AND INCOME TAX EFFICACY**

Goal: Income taxed at 30% corporate tax rate  
Capital gains subject to 50% discount capital gain  
Asset protection for individual

Initial investment funds can be gifted or loaned interest-free to a discretionary trust. Investments (income and capital growth) are made by the trust. Beneficiaries of the trust include individuals and a corporate. Shares in the corporate beneficiary are owned by the trust.



The discretionary trust will stream capital gains to individual beneficiaries and income to the corporate beneficiary. Actual cash distributions to the corporate beneficiary will only be sufficient to meet its income tax obligations, with the balance left outstanding as a present entitlement. That balance will be reinvested by the discretionary trust.

Unfortunately Section 115-200 explains it is required that Subdivision 115 C sets out rules for dealing with the net income of a trust that has a net capital gain. The rules treat parts of the net income attributable to the trust's net capital gain as capital gains made by the beneficiary entitled to those parts. This lets the beneficiary reduce those parts by any capital losses and unapplied net capital losses it has.

If the trust's capital gain was reduced by either the general 50% discount in step 3 of the method statement in subsection 102-5(1) or by the small business 50 % reduction in Subdivision 152 –C (but not both), then the gain is doubled. The beneficiary can then apply its capital losses to the gain before applying the appropriate discount percentage (if any) or the small business 50% reduction.

If the trust's capital gain was reduced by both the general 50% discount and the small business 50% reduction, then the gain is multiplied by 4. The beneficiary can then apply its capital losses to the gain before applying the appropriate discount percentage (if any) small business 50% reduction.

The rules also give the beneficiary a deduction if necessary to prevent it from being taxed twice on the same parts of the trust's net income.

Note that section 109UB of Division 7A of the 1936 Tax Act does not operate punitively where the trustee reinvests those monies rather than making a loan to a shareholder (or their associate) of the corporate beneficiary.

The trust will make a Family Trust Election and the corporate beneficiary will make an Interposed Entity Election to ensure that franking credits flow to corporate beneficiary (under 45 day holding period rules).

### 3. STRUCTURING TO NEGATIVELY GEAR

Goal:     Income taxed at 30% corporate tax rate  
          Capital gains subject to 50% discount capital gain  
          Asset protection for individual

Initial investment funds gifted to discretionary trust. That trust then loans interest-free to (or subscribes for share capital in) a company, being a corporate beneficiary of the trust.



That company then acts a financier, lending to individual at an appropriate commercial interest rate for unsecured loans.

#### Example

Mr X, a 48.5% tax rate taxpayer, borrows from Finance Company at 9% interest and invests in assets yielding 5% income plus long-term capital growth.

Since the income yield from investments is less than the interest on borrowings, Mr X's investments are negatively geared against his salary income.

Finance Company will pay 30 cents in the dollar on its interest income, the remaining 70 cents in the dollar being available to finance further investments by Mr X.

The use of the discretionary trust enables dividends paid by Finance Company on its winding up to be streamed to lower tax rate beneficiaries.

Discretionary trust needs to make a family trust election to ensure franking rebates on dividends from finance company (which will need to make an interposed entity election).

## Asset Protection

Loans can be secured against investments or other assets i.e. family home can be offered as security.

### 4. IS A DISCRETIONARY TRUST AN APPROPRIATE VEHICLE IN WHICH TO CONDUCT A SMALL BUSINESS?

If a business is being conducted through a discretionary trust and any one of the beneficiaries is entitled upon exercise of the trustee's discretion to more than 50% of the income and capital, then any of those beneficiaries would be a potential controller. A controller is a connected entity via the definition in Section 152-30(1) and 152-30(5). Accordingly, the conduct of a business through a discretionary trust where there is potential for the application of the small business concessions may be frustrated by the aggregation of all the net assets of all the nominated beneficiaries. This is confirmed by the following ATO Interpretative Decision.

ATO Interpretative Decision ID 2002/921

#### Issue

If gift deductible or income tax exempt bodies or the like are beneficiaries under a discretionary trust and the trustee has the power to pay any or all of the income or capital of the trust to those bodies are they connected with the trust in terms of section 152-30 of the Income Tax Assessment Act 1997 (ITAA 1997) for the purposes of the maximum net asset value test under sub-paragraph 512-15(a)(ii) of the ITAA 1997?

#### Decision

Yes. The gift deductible or income tax exempt bodies are taken to have a 100% interest in the discretionary trust under sub section 152-30 (5) of the ITAA 1997 and are therefore taken to control the trust under sub section 152-30 (2) of the ITAA 1997. The bodies are therefore connected with the discretionary trust under sub section 152-30 (1) of the ITAA 1997 for the purposes of the maximum net asset value test under sub-paragraph 152-15(a)(ii) of the ITAA 1997.

This question often needs to be looked at in the context of a charity being named as a remainder beneficiary. Usually a charity may obtain an interest in corpus upon vesting of a trust where the trustee fails to appoint the whole or part of the corpus, and subject to a default distribution order which provides that the interest of the charity will only arise as a last resort if none of the persons having priority are then living.

Accordingly, where a deed provides that the corpus is to be held as to fixed percentages for a class or classes of beneficiaries and the trust above will not arise until there is a default in vesting. Then provided the class or classes of beneficiaries having priority are in existence “just before the CGT event” then the trustee would not be in a position to appoint income or capital to the charity in its capacity as a remainder beneficiary. The assets of the charity could not be aggregated.

The position with clauses which include as beneficiaries “such charitable purposes and objects as the trustees may select” or “such other beneficiaries which the trustee in its absolute discretion may from time to time select” is uncertain. However, the better view may be that it would be unreasonable to interpret s152-30(5) in such a way as would require the net assets of every charity to be aggregated or every potential beneficiary. The legislature could not have intended such a result in bestowing the small business concessions and the decision in *Cooper Brooks (Wollongong) Pty Ltd v FC of T* 81 ATC4292 is authority for ignoring a possible literal interpretation, which leads to an absurd result which the legislature could not have intended.

Notwithstanding, the ATO currently takes the view that in the above circumstances the assets of the charity would be included.

One alternative may be to ensure certain beneficiaries deny their inclusion as a beneficiary or potential beneficiary in the trust.

In turn there may be scope to limit any one beneficiary’s interest in capital or income or less than 40%. Further in conjunction with a capital distribution, this approach may be used to allocate capital to a beneficiary and then have that beneficiary deny any further interest in the trust prior to the happening of the relevant CGT event.

In calculating the net asset value one may be able to take into account this liability and exclude its value from the aggregation of the net assets because of the exclusion of the beneficiary.

Section 152-20(1) states that:

“The net value of the CGT assets of an entity is the amount (if any) by which the sum of the market values of those assets exceeds the sum of the liabilities of the entity **that are related to the assets**” (emphasis added).

In the event that the trustee resolved to allocate capital to a beneficiary which resulted in a debt to the beneficiary, as an alternative to transferring specific assets i.e. the trustee was preserving the assets, could it be said that the debt relates to the assets?

The term “related to” is not defined in either the 1936 Tax Act or the 1997 Tax act. Further, the Explanatory memorandum to the New Business Tax System (Capital Gains Tax) Bill 1999, which introduced the current CGT small business provisions, does not address the meaning of that term. It is therefore necessary to determine its ordinary meaning. The Oxford English Dictionary states that the meaning of the term “relate” includes “connection” and “have reference to”.

It is noted that other parts of the Income Tax Assessment Act use the term “liabilities in respect of “ the asset or assets (see for example section 1220-20(1)(b)- CGT roll-over to a wholly owned company).

In a judgement of the Supreme Court of Canada in *Nowegijick v The Queen* (1983) 144 DLR (3<sup>rd</sup>) 193 at p 200, delivered by Dickson J. it was said that:

“The words ‘in respect of’ are, in my opinion, words of the widest possible scope. They import such meanings as ‘in relation to’, ‘with reference to’ or ‘in connection with’. The phrase ‘in respect of’ is probably the widest of any expression intended to convey some connection between two related subject matters”.

This statement has been endorsed by the Australian Courts in a number of cases (see, in particular, *FC of T v Holmes* 95ATC 4476 and *FC of T v Smith* 87 ATC 4883).

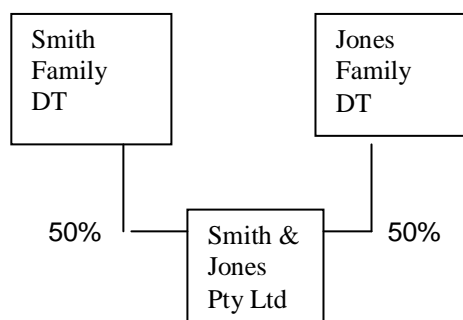
Since the payment to the beneficiary was in satisfaction of his/her interest in the trust corpus (i.e. trust assets) following the trustee resolution, and the monetary liability allowed the trustee to preserve the trust assets, arguably the circumstances that gave rise to the debt to the beneficiary demonstrate that the liability is related to the trust assets. The issue of renunciation by a beneficiary was raised by the ATO in paragraph 1 of the taxation Determination TD 2001/25: “A renunciation by a beneficiary of an interest in a discretionary trust (the interest being a CGT asset) would give rise to CGT event C2 for the beneficiary because it is the abandonment surrender or forfeiture of the interest (s104-25 of the 1997 Act)”.

The determination proceeds on the assumption that such an interest is a CGT asset and at paragraph 2 points out that such an interest would usually have a nil cost base and a nil market value with no resultant CGT consequences.

Further it is worth noting that the ATO have denied the application of subdivision 124 –N roll over relief to discretionary trust in interpretative decision ID 2002/955 by stating that a beneficiary of a discretionary trust does not own an interest.

## 5. WHAT ABOUT A COMPANY OWNED BY DISCRETIONARY TRUSTS?

Firstly, let us look at a company where the shares are held by two unrelated families through their respective discretionary trusts as in the example below:



Assume the net assets of Smith & Jones Pty Ltd are \$3 million, including goodwill and an offer has been made to acquire the business for that amount. The purchaser is ambivalent as to whether it acquires the shares owned by the two discretionary trusts or the business as a going concern.

### 5.1 Acquisition of the Business

Both the Smith and Jones discretionary trusts are deemed to be controllers of Smith & Jones Pty Ltd.

The \$5 million threshold will be calculated by adding the net value of the requisite assets of all the members of the Smith and Jones family, as they will all be connected entities i.e. they can all theoretically get 40%.

Note: It may be appropriate to exclude beneficiaries or have the deed specify that no beneficiary can be allocated more than 39% of the income or capital of the trust as mentioned in 4 above.

However, if those totals still do not breach the threshold, the concession will be available at the company level.

### 5.2 Acquisition of Shares

In order to take advantage of the concession, the additional tests in Section 152-10 must be passed.

- a) the company must satisfy the controlling individual test in Section 152-50; and
- b) you are a CGT concession stakeholder in the company. CGT concession stakeholder is a new concept introduced for the first time in Division 152.

The assets of each trust do not need to be aggregated in order to arrive at the \$5 million threshold, as they are not connected. In circumstances such as those in the example it is possible to have two controllers and they both can take advantage of the concession.

However, where there are discretionary trusts involved it will be necessary to establish that just before the CGT event there is an individual who can demonstrate he or she has 50% of the legal and equitable interests in the shares. It is unlikely this can be achieved at the discretionary trust level without giving rise to CGT event E5.

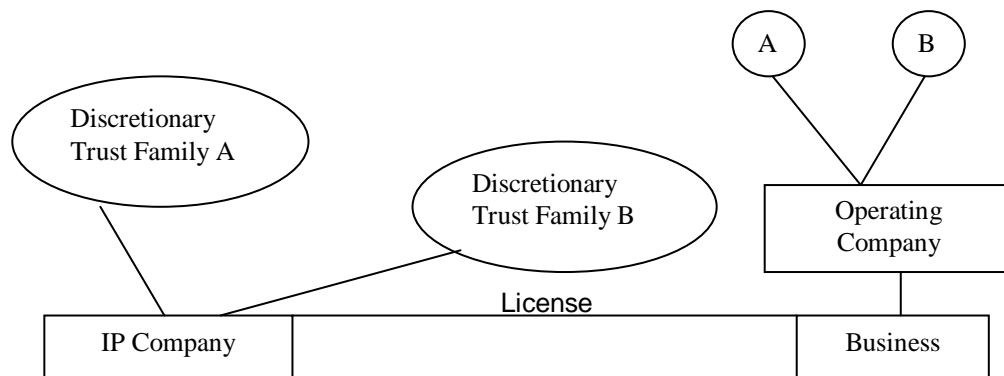
However, notwithstanding the further requirement that the seller must be a concessional stakeholder will be breached. The seller here is the trustee who can never be a concessional stakeholder.

Accordingly, when looking at appropriate structures for small business going forward a company owned by a discretionary trust or trusts would not be all that attractive.

## **6. Holding CGT Assets Separate to the Business**

Where the structure might be used:

- A and B are to go into business together
- The business uses intellectual property ('IP') consisting of a process, some procedures and know how that has been developed in the past by A.
- They want to develop the IP by undertaking further research and also want to commercially exploit what has been done so far.
- The entity may be floated in the near future, but the venture is risky. While the work on the IP done so far has resulted in some commercially exploitable outcomes, even more benefits might be gained through the further research.
- The parties recognize that there may be the need to introduce new equity partners prior to the float.



- A and B has equal shares in the operating company. The directors of the entity are A and B.
- The intellectual property of the enterprise will be sold by A to the IP Company. It will then be licensed from the IP Company and the license is cancelled if the business fails for any reason.
- The IP Company is equally owned by the discretionary trusts controlled by A and B. The directors of the IP company are A and B.
- A shareholder agreement will be put in place and signed by A and B and the trustees of their discretionary trusts. It will outline the sell-out terms, what will happen in the event of the death of a party and how power will be shared, amongst other things.

### **Asset protection benefits**

The IP is protected by holding it in a different vehicle than the operating enterprise. If the operating enterprise fails, the license will be cancelled and the IP Company can license the IP to a new company.

In addition, bringing in any equity participant does not automatically mean that they will share in the ownership of IP. That can be decided as a separate issue as the IP is owned by the IP Company and not the Operating Company.

### **Introducing equity participants**

Equity participants can be easily brought into the Operating Company by issuing shares. The value shifting rules will not apply if the new equity participants are not associates of A or B.

### **Listing the enterprise**

A company is the ideal vehicle to proceed to listing. Corporate structures are generally accepted amongst large investors, and this could be the vehicle used in a later float.

## Minimisation of Income Tax

The company tax rate is low at 30% and the R&D concessions can be claimed by IP Company .

In addition, by the use of corporate beneficiaries, dividends paid by the IP Company will not need to bear tax.

## Minimisation of Capital Gains Tax

as the shareholders in the operation company are individuals, on the sale of their shares they will be able to access the 50% general discount. Any capital gains on the sale of the shares in the IP Company by the trusts would be reduced by the CGT general discount.

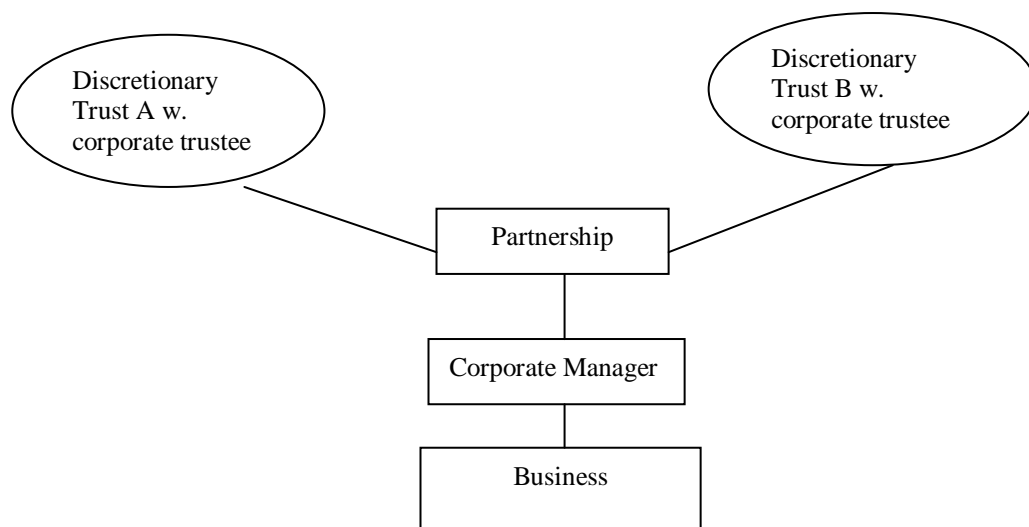
Although the structure is not optimum for access to the CGT small business concessions, if the \$5M net assets was able to be met, the companies could potentially claim the concession on the sale of the business and the IP.

It would need to be determined what price A would sell the IP company for, but A might be able to access the CGT general discount on the disposal if the eligibility criteria are met.

## Control

The shareholder agreement provides for reasonable certainty in the relationship between the parties, it will only be of use between the parties if they are prepared to honor it or pursue breaches of it in Court.

## 7. *Partnership of Discretionary Trusts*



- The discretionary trusts borrow to fund the acquisition of the business. The business property is used as security for the borrowings.
- A corporate manager is appointed for the partnership. The directors of the company are representatives of A and B.

### **Asset Protection**

The partners will have joint and several liabilities for the debts of the partnership. As the trusts have corporate trustees and would be only to hold business assets, only the business assets, not the controllers' assets, are at risk.

This produces a better situation than if the partners were individuals when personal assets would be at risk.

It also produces a situation similar to that where the business was undertaken through a company, as all the assets of the business would be available to the creditors but not personal assets of the shareholders.

### **Income tax minimization**

Income received by the partnership will flow through to the discretionary trusts and can then be distributed to a corporate beneficiary or low marginal tax rate beneficiaries.

### **Capital Gains tax minimization**

Capital Gains Tax is minimized through access to the various concessions. As the partners are trusts they will be able to access the discount concessions in relation to partnership assets. In addition, each partner should be able to access the small business CGT concessions in respect of the partnership assets. Access to these concessions is one of the advantages of this structure over a unit trust owned by discretionary trusts. Of course it will only be relevant where the \$6M net asset threshold test is passed.

### **Ease of Administration**

This structure requires at least two trusts (one for each partner), each with corporate beneficiaries. In addition, a partnership and a corporate manager are required. At a minimum there will be four active entities to account for (two discretionary trusts, a partnership and a corporate manager).

### **Understandability**

This structure is moderately complex and could be difficult for a client to understand. However in practical terms it should be able to be operated on broadly the same basis as a regular partnership.

### **Admitting new partners**

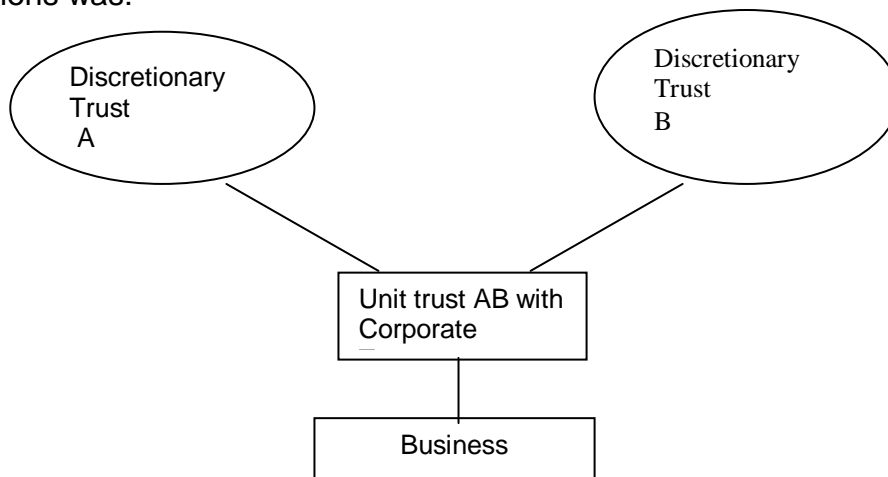
This will involve the same issues as for regular partnership. The main issues are in relation to payments for work in progress and potential capital gains tax liabilities for continuing partners.

## Other

A corporate front is obtained by using a company manager. The company is appointed agent for the partnership in the partnership agreement. This allows the partnership to present a corporate front which is more acceptable in the general business community than a partnership of discretionary trusts. In the partnership agreement trust A and trust B will agree to indemnify the corporate manager for any debts it incurs on behalf of the partnership.

### 8. Discretionary Trusts Owning a Unit Trust

A structure that was popular before the introduction of the CGT small business concessions was:



- The discretionary trusts borrow from the bank to acquire units in the unit trusts. The unit trust's property is used as security for the borrowing.
- The loans from the bank fund the acquisition of units by the discretionary trusts.
- The directors of the corporate trustee are representatives of the two unrelated parties.

### Asset Protection

Protection from business risk is achieved by using a corporate trustee for the trading entity.

### Introduction of equity participants

Equity participants can easily be introduced by issuing new units in the unit trust. This will not cause immediate tax consequences for the existing unit holders. If another structure was used they might have to sell a portion of their interests which would have increased in value since establishment, triggering CGT.

### Minimisation of income tax

Income will flow through the unit trust to the discretionary trust and can be streamed to low income tax rate beneficiaries. Building allowance claims and the benefits of any small business concessions will be partially clawed back on distributions out of the unit trust. Can refinance trust capital and claim a deduction for the interest on the loan.

### **Minimisation of capital gains tax**

The 50% active asset concession and the replacement asset rollover can be accessed on the sale of the business. The 15 year retirement exemption and the retirement concession cannot be accessed as the discretionary trusts are not controlling individuals.

None of the CGT small business concession can be accessed if the units in the trust are sold instead of the business.

### **Losses**

On the basis that the unit trust is a fixed trust for the purposes of the trust loss provisions in Schedule 2F, one of the tests the unit trust would need to satisfy in order to utilize losses is the 50% Stake Test or Alternative 50% Stake Test. The unit trust can satisfy the 50% Stake Test if discretionary trust/s holding at least 50% of the units in the unit trust have made Family Trust Election/s. This is because s272-30(2) of Schedule 2F treats the interest held by the family trust as if it were beneficially held by an individual.

The Alternative 50% Stake Test can be satisfied if every discretionary trust (other than a Family Trust or other excepted trust) holding units in the unit trust would satisfy the non-fixed trust loss tests (i.e. control test, pattern of distributions test and income injection test) if they stood in place of the loss trust, and there must have been no change in legal ownership of units throughout the test period (s266-45 of Schedule 2F).

### Other issues

The entitlements of the parties to income and capital are fixed because of the use of a unit trust. Comparing the above structure (which was popular until the small business concessions and amendments to CGT event E4) with a partnership of two discretionary trusts mentioned above:

<b>Issue</b>	<b>Partnership of discretionary trusts</b>	<b>Unit trust owned by discretionary trusts</b>
50% general discount	passes through	passes through
15 year retirement exemption	available	not available – does not have a controller
Active asset reduction amount paid out on sale of business	not diluted	partially clawed back through CGT event E4
Retirement exemption on sale of business	available	not available- does not have a controller
CGT small business concessions on sale of interest in participant or units (as applicable)	can be accessed	cannot be accessed
Building allowance	passes through	clawed back
Admission of equity participants	can result in CGT if partial interest sold to incoming partner	no CGT if new units issued. Can result in CGT if units sold incoming equity participant
Trust losses	each trust can make a family trust election	Unit trust can only make a family trust election with respect to one trust causing family trust distribution tax problems
Distribution flexibility	good	good
Franking credits	can pass through	

## **9. Partnership for Personal Services**

This structure would generally not be appropriate where the income derived by the partnership is “personal services income” i.e. income derived mainly as a reward for the personal efforts or skills of an individual. The very recent decision of the Administrative Appeals Tribunal (AAT) in *Re Jones and FCT* (Ref No; QT 2001/426-428, McCabe M, 31 January 2003) is, however, of some interest.

In that case the AAT Suggested that, as a matter of principle, it might not be possible to apply the general tax anti-avoidance provisions (Part IVA Income tax Assessment Act 1936) to any partnership.

The taxpayer was an engineer who returned his taxable income on the basis that he was carrying on his consultancy business in partnership with his wife. In considering whether tax avoidance shortfall penalties should apply, the AAT concluded that the general tax anti-avoidance provisions would not have applied to the taxpayers as neither they nor their advisers had the dominant purpose of obtaining a tax benefit. One factor taken into account was bona-fide nature of the wife’s involvement in the partnership.

The AAT found it difficult to conclude that a partnership was a tax “scheme”, as the existence of a partnership was a question of legal fact or a state of affairs. Further, the AAT pointed out that the explanatory memorandum accompanying the introduction of Part IVA suggested that a partnership arrangement would not be caught by those provisions.

Similarly the AAT in *Re Macarthur and FCT* (Ref No: QT2000/185-189 Beddoe SM 29 October 2002) found that PTIVA did not apply to an arrangement whereby a former employee of the Dept of Main Roads (DMR) later contracted his service to the (DMR) through a family company which carried on engineering consultancy work. The AAT found that as the taxpayer had not been employed by the DMR for a number of years before the engagement of his service through the company, there was no “tax benefit” that could be said to have arisen from the arrangement.

Specifically, the AAT held that it could not be said that, as a result of the arrangement, an amount was not included in the taxpayer assessable income that would have otherwise been included. This was because the taxpayer had no subsisting contract of employment with the DMR. In addition, the AAT was not satisfied that if the company had not entered into the contract with the DMR, the taxpayer would have done so himself.

On appeal however the court remitted the case back to the AAT as they had erred in the interpretation of PTIVA on the basis that the AAT could not find an amount that would have been included in the taxpayer's assessable income whereas they should have enquired as to whether an amount might reasonable be expected to be included.

## **10. Summary**

There is clearly no one ideal solution for all situations, however bearing in mind the problems with tax-free distributions from a unit trust, this might be an appropriate vehicle.

The features would include:

- Units are held by individuals
- The trustee is a company giving some limited liability
- Avoid holding in the ratio of 50/50 if the intention is to sell the business a 49/51 split may only lead to one connected entity for the purposes of the \$6 million threshold. Note also that the test is just before the CGT event. Accordingly, some restructuring now in the absence of an offer may be appropriate and not fall foul of the anti-avoidance provisions.
- The 50% discount capital gain would be available to the trust and able to be distributed without case base adjustments
- Some income units may be held by a company for each unit holder
- Alternatively, it may be appropriate for individuals to hold capital appreciating assets and lease them to a company. However, goodwill will usually accumulate in the operating entity.
- A partnership of discretionary trusts may also be appropriate but there are inherent CGT problems on introduction of a new equity partner

