

**Business Tax & Estate Planning  
Report & Recommendations  
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Alison Clare Cotter**

**Chevelis Pty Ltd  
Exentricity Pty Ltd  
Haroi Marketing Pty Ltd  
Phoneware Unit Trust**

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## 1. LEGAL STRUCTURE

The structure of the Cotter business interests is trading companies owning units in a property unit trust. Phoneware Unit Trust. Our recommendations follow to interpose asset protection strategies and to create a platform for future acquisitions and the most tax efficient structure for revenue and capital gains taxed events.

We have restructured Exentricity Pty Ltd to operate as a Finance Company with its shares being equally held by two discretionary trusts, namely, Chevelis Pty Ltd as trustee for The William Cotter Trust and Haroi Marketing Pty Ltd as Trustee for The Alison Cotter Trust. A charge or mortgage to be taken over the main residence in favour of Exentricity Pty Ltd with the ownership off that security vesting with The William Cotter Trust and The Alison Cotter Trust This structure is an attempt to have some asset protection but also retain the entitlement to principal residence exemptions currently and continually available to Alison Clare Cotter.

Advantages:

1. Individual can utilise the capital gains tax exemption where the property is the family home.
2. Asset protection to the level of secured debt
3. Tax free threshold for Land Tax.
4. The ongoing future assets for example, real estate, goodwill , other tangible and intangible assets are acquired by, say the partnership of The William Cotter Trust and The Alison Cotter Trust so as to take advantage of the capital gains tax concessions and those assets are leased or licensed to the trading entity.
5. Income splitting can occur where trust income is distributed to the beneficiaries on lower marginal tax rates. The use of a corporate beneficiary would also provide access to the low company tax rate of 30 per cent.
6. A restructure of the trading entity should be considered and in particular superannuation fund strategies utilising creditor proofing of assets and capital gains advantages associated with Trust structures and property and investment acquisition arrangements tabled and considered along with a written investment strategy for the present SMSF (Self Managed Superannuation Fund).

## 1. TAX IMPLICATIONS

In view of the most recent balance sheets the implications are as follows:-

- We comment on the capital structure of Chevelis Pty Ltd as to whether the goodwill generated by the acquisition and development of various business interests and intellectual property has been formally identified in the balance sheet.
- We further comment that a Company is not the preferred entity for any capital growth assets as the 50% discount afforded to Individuals and Trusts is lost at the shareholder level in proprietary companies. This valuable concession up to \$5M should be incorporated in the planning of future income tax and capital gains tax outcomes.

## 2. BUSINESS OPERATIONS

Modern business contains many ‘filters’ like taxation, payments to staff, bureaucratic adherence, local disciplines, export/import restrictions, etc that limit the conversion of turnover to a cash profit. Your assets are business and non-business and each must be treated in very different ways. It is important to house business assets, financial assets and property assets in the appropriate vehicle to optimise the conversion of pre-tax cashflow to capital growth or debt retirement. Furthermore, all three must be in balance at all times to give provisions of security, flexibility and manageability. Each of the business entities - operations, properties and financial to be operated on separate and distinct securities, even if this involves using different bankers and institutions for each entity.

The most tax effective part of the financial operations will be the superannuation fund. It maybe helpful to picture the tax and business structure as a plan superimposed on your lifeline, a horizontal line stretching forward from today into the future.

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At the front end of the line will be you in business moving forward, coming in from the other end will be another business, wholly owned by you but not incumbent on your time and operating on a tax advantaged basis, namely your superannuation fund.

As you progress forward in today's business, so too will your tax-advantaged business be coming in from the other end, towards you. When the two meet you are financially independent.

So to have balanced growth, the Cotter family business has to be unbundled into operations, property and financial entities. The major operations sub business being the structuring of a separate trading entity which will be set up to be a trading operation and will only have goodwill as a growth asset. This Unit Trust will employ William Cotter and Alison Cotter through their respective Discretionary Trusts and a service contract will be negotiated to manage and maintain the Cotter Business and Property entities.

In turn the Phoneware Unit Trust would enter into a management contract between itself and William and Alison Cotter Trusts which would employ yourself and family members to the following aspects.

1. The provision of executive services for the management of Cotter business interest.
2. The payment of appropriate management fees.
3. Security for payment of the management fees.

It is intended that the William and Alison Cotter trusts provide for the management under contract of the operating entity plus matters incidental to that management and ideally the full management infrastructure.

The major property sub business will be a Phoneware Unit Trust that will use the tax advantage of the superannuation funds contribution as tax deferral to acquire properties on a pre-tax basis not post-tax basis. In a phrase create other independent profit centres.

Recognise that your business is a money generator. The generation is there to:-

1. Provide you with an acceptable standard of living.
2. Create, enhance and secure ultimate financial independence.

3. Provide cash to fund your business during the next cycle.
4. The unit trust and the superannuation fund provides that the Cotter business interests is not left to consume all that it generates.

### **CGT Rollover Relief**

CGT rollover relief may be available where the business is transferred from:-

- (I) An individual or a trust to a company:
- (II) A partnership to a company: or
- (III) One group company to another group company:

Each of the rollover relief provisions has various conditions to be satisfied.

Where the rollover relief conditions are satisfied then:-

- (I) The transfer is not a disposal for CGT purposes;
- (II) Pre-CGT assets retain the status in the recipient company even if the company was established after 19<sup>th</sup> September 1985.
- (IV) Post-CGT assets keep the cost base in the recipient company that would have applied if there had been a disposal to an arm's length party.

Also for a transfer by an individual, a trust or a partnership (but not a transfer between group companies) the shares issued as consideration by the recipient company.

- (I) Will be pre-CGT assets to the extent which they relate to the transfer of one or more pre-CGT assets; and
- (II) Will have the same cost base that applied to any post-CGT assets which have been transferred.

#### 4. VALUATION OF GOODWILL

It is accepted that goodwill is property, but its attributes defy a universal definition. Perhaps the most comprehensive definition is that in Halsbury's Laws of England, 4th ed, paragraph 1, 106 and 1, 109:

“The goodwill of a business is the whole advantage of the reputation and connection formed with customers together with the circumstances, whether of habit or otherwise, which tend to make that connection permanent. It represents in connection with any business or business product the value of the attraction to customers which the name and reputation possess... A distinction has been drawn between personal goodwill, which is merely the advantage of the recommendation of the owner of a business and of the use of his name, and the local goodwill, which is attached to premises, and must be taken into account in calculating the value of such premises. There may be goodwill attached to a business which depends upon personal relations between the man who carries it on and his clients or customers, such as the business of a stockbroker, or a solicitor, or notary or a surgeon or doctor, or a dentist; and even though a successor may not use the old name, it may be an advantage of appreciable value merely to be a successor, though in some cases such goodwill may be so worthless as to be unsaleable.”

In *Trego v Hunt* (1896) AC7 Lord Herschell said at pp 17-18 of goodwill:

“It is the connection thus formed, together with the circumstances, whether by habit or otherwise, which tend to make it permanent, that constitutes the goodwill of a business. It is this, which constitutes the difference between a business just started, which has no goodwill attached to it, and one, which has acquired goodwill. The former trader has to seek out his customers... The latter has a custom ready made. He knows what members of the community are purchasers of the articles in which he deals and are not attracted by custom to any other establishment.”

## 5. RESTRICTIVE COVENANTS

For there to be an effective transfer of the goodwill of a business usually the vendor(s) will need to enter into a restrictive covenant not to compete for a specified period within a specified locality. If there is a stated consideration for the restrictive covenant this may give rise to capital gain.

## 6. CGT AND GOODWILL

In essence, any Taxable Capital Gain arising from the sale of a business is reduced by half if the value of the business is sold, and any associated business is less than the current concession threshold of \$5M.

Goodwill, surprisingly, is not defined in the tax legislation, and the numerous judicial decisions that have referred to the concept unfortunately provide little practical guidance. It is clear that goodwill can only exist in connection with the business and can be made up of a variety of factors including location, business contacts, product reputation and personal relationships. What is less known are some items that can often qualify as goodwill, including:

- Business Names
- Patents
- Agencies
- Software
- Restrictive Covenants
- Distributors
- Client Lists
- Rent Rolls
- Trademarks
- Franchises.

It would be fair to say that some of these items would not be included in an assessment and calculation of goodwill, but, instead, their values would be assigned under asset headings. This can be a mistake.

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In *FC of T v Krakos Investments Pty Ltd* 96 ATC 4063. The court recognised that the goodwill of a Hotel might consist of site, name, monopoly and personal goodwill, the latter of which might be difficult to transfer. The views of the Taxation Office are contained in TR 1999/16

“ Goodwill is the product of combining and using the tangible, intangible and human assets of a business for such purposes and in such ways that custom is drawn to it. The attraction of custom is central to the legal concept of goodwill. Goodwill is a quality or attribute that derives among other things from using or applying other assets of a business. It may be site, personality, service, price or habit that obtains custom. It is more accurate to refer to goodwill as having sources than it is to refer to it as being composed of elements. Goodwill is a composite thing. It is one whole. It is an indivisible item of property that is legally distinct from the sources from which it emanates. It is something that attaches to a business and is inseparable from the conduct of a business. It cannot be dealt with separately from the business with which it is associated” (paragraph 12 of TR 1999/16).

An exemption of up to 50% of any capital gain is available to taxpayers on a CGT event happening at or before 11.45 AM on 21 September 1999 affecting Goodwill where the associated business was acquired or started after 19<sup>th</sup> September 1985 (s. 118-250 now repealed) As an alternative, Taxpayers may be able to avail themselves of the small business rollover relief or retirement relief. For CGT events effecting Goodwill after 11.45 on 21 September 1999 the 50% exemption is not available although a taxpayer may obtain relief under the small business CGT concessions in Div 152.

Goodwill is acquired on the date the business to which the Goodwill is attached is acquired or commenced (IT 2328). If a business was acquired or started before 20 September 1985, CGT does not apply to business Goodwill as it is taken to be acquired prior to 20 September 1985.

Obviously, an initial liability for capital gains tax only arises where the goodwill is taken as having been acquired post-CGT. The relevant tax ruling, IT 2328, provides that on the sale of a business acquired pre-CGT, no liability to capital gains tax arises, notwithstanding that a proportion of the goodwill would in reality be referable to a period after 19 September 1985.

The legislation stipulates that the net value of the business being sold, and any other associated businesses of the relevant taxpayer, must be less than \$5M. If the taxpayer is an individual, associated businesses include any other business carried on by the taxpayer. In a similar manner associated businesses of taxpayer companies include those carried on by the company but with the additional requirement that if the company is part of a 100% commonly owned company group, the net value of businesses carried on by other members of the group are also included as associated businesses.

Where, on an initial examination, the anticipated proceeds of a proposed sale may appear to exceed the threshold amount, there are a number of possible steps a taxpayer can take to come within it. If the taxpayer at issue is a company, and if the funds are available, the company should consider declaring a dividend, thus reducing the net value of the business. Borrowing to fund a dividend accomplishes the same result, since the resultant liability to repay the debt decreases the businesses net value.

Where the contemplated sale is of a business operated by an individual, the inclusion of other businesses carried on by the taxpayer in the threshold calculation may mean the concession is not available. However, it appears that the meaning of “associated business” is restricted to businesses literally carried on by the same individual. Therefore a taxpayer should consider transferring any other businesses to controlled companies in order to qualify for the concession. If the business is held by a company, as distinct from the individual taxpayer, it will not constitute a business “carried on” by the taxpayer.

Another approach to beating the threshold arises in a situation where a number of businesses are due to be sold. Because the concession does not operate cumulatively, each business should be disposed of at slightly different times. When the combined net value of two associated businesses due for sale is over the threshold, the business with the least value should be sold first, and “sacrificed”, in order to maximise the amount of exemption available for the concession.

## **7. COMPANIES**

Unfortunately, as the law stands at present, shareholders of companies who obtain the concession may effectively be in no better a position than if the concession had not been claimed at all. This odd result is due to the fact that the tax-free component of the capital gain cannot be distributed free of tax to individual shareholders, since it emerges as an unfranked dividend.

Therefore, during the planning stages of a proposed business incorporation, every attempt should be made to consider the issue of goodwill, and, if it emerges as a vital factor, a taxpayer may be better advised to remain a sole trader, or, alternatively, establish a discretionary trust with a company as trustee.

It will be obvious from the foregoing that goodwill represents a fertile field for tax planning. No commencement, purchase or sale of business should take place without adequate and detailed consideration of goodwill and associated tax planning issues.

## **8. ANALYSIS OF TAX STRUCTURES**

We attach (Appendix 3) a method of measuring the equity of a tax plan by comparing the “net of tax” business benefits arising to the Cotter family operating the same business under different acceptable tax structures.

At all income levels, including the private company at the \$200,000 and \$500,000 income levels, the discretionary trust is a superior tax structure.

## **9. TRUSTS**

Frequently, trusts are chosen as the vehicle for operating a business. The question of whether to use a Discretionary Trust or a Unit Trust is not a simple matter. The following sometimes conflicting factors maybe relevant.

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Frequently, trusts are chosen as the vehicle for operating a business. The question of whether to use a Discretionary Trust or a Unit Trust is not a simple matter. The following sometimes conflicting factors maybe relevant.

A Discretionary Trust allows greater flexibility with the allocation of income and capital.

A Unit Trust establishes clearly the entitlements of different beneficiaries, which is especially important when two or more families are involved.

Financial Institutions may prefer to lend to a Unit Trust rather than a Discretionary Trust.

Usually a Discretionary Trust will be preferable to a Unit Trust. This is due to the potential for effective loss of the benefit of indexation that is associated with a Unit Trust due to provisions of Section 160ZM of the Act. This reduces the cost base of the unit's by the amount of any non-assessable distribution

A significant advantage which trusts have over companies is their ability to stream different types of income to different beneficiaries. Since amounts retain their character as they pass through a trust ( see *Syme v FCT (Vic) [1914] AC 1013*), trusts are able to direct amounts of income and capital to beneficiaries for the most tax effective result.

Other forms of assessable income that may be appropriate to stream include:

- taxable capital gains to flow to beneficiaries being individuals so that the CGT 50 per cent general discount may be applied.
- Taxable capital gains to entities with carried forward tax deductible capital losses.
- Franked dividends to beneficiaries being individuals with low marginal rates of tax- allowing refund of imputation credits in whole or in part.

Streaming is difficult for companies due to the fact that amounts change their character going through a company ( they are converted to dividends) and there are complex anti-streaming provisions for franked and unfranked dividends in s 45A to 45C of the ITAA36 and s204-15, 204-20 and Subdiv 204-0 of the *Income Tax Assessment Act 1997 ("ITAA97")*

A properly drafted trust deed should allow for streaming of all different amounts of income and capital.

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## 10. CONFERENCE OF THE PARTIES

We recommend a Round Table Conference with Barry Simmons to discuss our report and recommendations relative to the restructure proposal. The final step in the Succession Plan and orderly Estate Plan of William and Alison Cotter is the review of wills creating testamentary trusts. Before testamentary trusts are even contemplated, it is important to assess what estate planning actions and documentation are needed, if objectives are to be achieved. Possibilities include

- The preparation of Wills (and sometimes other) Powers of Attorney.
- The nomination of preferred Dependants to the Trustee of a Superannuation Fund.
- A switch to a self-managed or excluded fund (e.g. if there is concern about how the existing superannuation trustee might exercise its – usually- absolute discretion).
- Amendments to the Deeds for both excluded superannuation funds and discretionary trusts to ensure that future exercise of the trustee's absolute discretion and (in the case of a discretionary trust) the appointors power of appointment are properly exercised and deadlocks are avoided.
- The immediate or provisional (e.g. irrevocable on death) of discretionary trusts and other entities.
- The “tidying up” (with the concurrence of the relevant beneficiaries) of unpaid trust allocations.
- Realignment of the beneficial ownership of insurance policies, e.g. a switch from cross to self-ownership of personal life insurance so that a testamentary trust can be funded.
- The preparation of business succession, pre-nuptial or pre-relationship or other agreements.
- The immediate or progressive transfer of assets away from personal ownership to spouses, discretionary trusts or superannuation, e.g. to forestall challenges or achieve asset protection.

Where does this leave the present structure? The past decade has seen a decline in the use of trading companies. Except for its use as a corporate beneficiary, William & Allison Cotter should not intend to acquire and hold appreciating assets in a company. We recommend the use of Unit Trusts as a structure with Discretionary Trusts for each of William and Alison Cotter's interests. It appears that your current structure has been "event driven" rather than encompassing long range planning. This is typical of a growing business and by no means a criticism, as long as the proprietors recognise the fact and undertake rectification when required.

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It is our experience that adversity to a business structure can be commercial, political, ie within the group) or from domestic sources. Business persons like yourself survive on your own merits and it is only damage to your "commercial vehicle" which may restrain or distract your commercial enthusiasm. In this vein your current structure necessitates the continuance of a business.

This is bought about by the following:

- i. Although you have a company holding your business interests , you could be prevented from "doing business: should an understanding between you cease.
- ii. If this is bought about the Cotter family business interest can result in a "hung" operating directive and either party could (given circumstances) injunct the company structure from conducting certain business.
- iii. In a similar manner should you become under creditor attack or be involved in some adverse litigious position which renders you bankrupt or a receiver manager appointed to your business, the appointed trustee would control all other investments and you family's destiny.
- iv. This positioning statement, because of the complexity of our bureaucratic operating platform, plus the enormous cost of litigation will ultimately become "control without ownership."
- v. It is our belief that the main purpose of a business structure is to perform the following subjects, in the given order of priority:
  - Retained flexibility
  - Preserved continuity of the business
  - Preservation of assets
  - Protection to proprietors (physical, moral and social)
  - Minimised taxation liability

Every tax plan should include both short term and long term goals. Some particularly tax related ones arise yearly or even more often. Other goals, those associated with safeguarding and building assets - may span generations. The foundation of your wealth accumulation is therefore the tax management aspect, the component parts of achieving financial independence must be coordinated with risk management, to safeguard assets against unexpected losses and asset management, for utilising today's wealth and building tomorrows.

We have skills in corporate advisory, self managed superannuation strategies and management consulting and business intelligence in accounting consulting and law, which ideally positions us in your operating business entity to make recommendations to improve your tax and business structure and at the same time partially immunise you from a domino effect should you trigger an adverse investment situation or a major bad debt or prolonged litigation in your commercial entity.

11. **Summary**

Further Advanced Tax Planning discussion should take place to position your Operations, Property and Financial interest for maximum overall flexibility in Tax Planning and more specifically Estate Planning. In turn any business plan can only be regarded as part of an overall succession plan involving personal, business, family and other related interests. An overall review is essential to help achieve the objectives of:

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

Assets held by any business or family trust belongs to the trust and do not form a part of the 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.

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 you 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.

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We trust this review is timely and look forward to your input and discussion.

Yours sincerely,

C John Pearson C.M.C PNA FTIA