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## IN THIS ISSUE



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### RESTRUCTURING BUSINESSES TO CORPORATE ENTITIES

There are compelling reasons to transfer businesses from trusts to companies. The major advantage of operating a business through a company is the ability to retain income. The income can be distributed to shareholders across different income years and therefore, companies provide a vehicle that can be used in a flexible manner for planning purposes.

Trusts need to distribute all their income to its beneficiaries to avoid trustee tax at 47% being payable. However, even when the income is distributed to beneficiaries, the tax payable at the beneficiary level could be as high as 47%. Another attractive feature of operating a business through a company is the lower corporate tax rate for base rate entities. The tax rate for such entities is currently 26% and will reduce to 25% on 1 July 2021.

Historically, the argument for using trusts rather than companies to carry on businesses has been the ability for a trust to utilise the 50% CGT discount upon the future sale of the business. This is still a relevant argument, but not as compelling as it used to be. For an individual at the top marginal tax rate of 47%, a discounted capital gain would be taxed at 23.5%. If we compare this rate against the corporate tax rate of 25% from 1 July 2021, the differential is not significant. In the long run, a company that is taxed at 25% annually on its business income could prove to be a more tax efficient vehicle.

So how could we restructure a business from a trust to a company?

Utilising the Small Business CGT Concessions could be the most beneficial option, as the value of business assets would be reset to market value upon transfer. However, in many instances the conditions to satisfy the Concessions cannot be met, or it would be impractical to use the Concessions if, for instance, the Retirement Exemption is utilised and funds are required to be transferred to a superannuation fund.

The other option to consider is utilising a CGT rollover. The two relevant CGT rollovers to consider are the following:

- Subdivision 122-A Rollover
- Subdivision 328-G Rollover

The 122-A Rollover is the 'simplest' rollover to utilise in the sense that satisfying the rollover conditions are fairly straightforward. The rollover simply requires the relevant trust to transfer its business across to a wholly owned company. The value of the shares in the company after the restructure must be substantially the same as the value of the business transferred. This is easily achieved by establishing a new company that is wholly owned by the trust (i.e. a company without any assets prior to the transfer of the business).

One important restriction under the 122-A rollover is that there cannot be any consideration other than shares in the company (and the assumption of liabilities of the trust) under the rollover. That is, there is no ability for the business to be transferred at market value to the company resulting in the company owing an amount to the trust which could either be available for future cash drawdowns or UPE offset.

The 328-G Rollover is also available for a business being transferred from a trust to a company. Unlike the 122-A Rollover, the transfer can occur for consideration, which is a unique feature of this rollover. While the rollover itself can provide significant advantages, there are practical difficulties in satisfying the requirement that the restructure must be a 'genuine restructure of an ongoing business'. The ATO takes a strict and narrow view of this requirement. For instance, if the restructure occurs for the purposes of succession planning or is a preliminary step to facilitate the sale of an asset, the genuine restructure requirement will not be satisfied.

If the genuine restructure requirement cannot be satisfied, the 'safe harbour' rule can be relied on. Under this rule, for a period of three years, there cannot be any change in the ultimate economic ownership of the asset transferred, the asset must continue to be an active asset and there cannot be any significant private use of the asset. While the safe harbour rule provides a three year period with certain restrictions, the ATO takes the view that Part IVA can apply if any of these restrictions to the relevant asset occurs after the three year period.

The restrictive nature of the genuine restructure requirement and the uncertainties around the safe harbour rule often leads to the 328-G Rollover not being utilised. The 122-A rollover can achieve the objective of transferring a business from a trust to a company in a much simpler manner.

If you have any queries in relation to the above please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

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## NEW ATO GUIDANCE ON TRAVEL EXPENSES

The Australian Taxation Office (**ATO**) has recently finalised the guidance on the deductibility of transport expenses in the form of Taxation Ruling TR 2021/1 and released the long-awaited ruling on the deductibility of accommodation, food and drink expenses in the form of draft Taxation Ruling TR 2021/D1 and Draft Practical Compliance Guideline PCG 2021/D1.

The new rulings and guidance replace the draft Taxation Ruling TR 2017/D6 and contains important information for individual taxpayers incurring the expenses as well as business employers reimbursing or paying for employees' transport, accommodation, food and drink expenses.

**Transport Expenses**

The general rule is that transport expenses incurred by employees whilst travelling between home and a regular place of work are not deductible, while those incurred in travelling between work locations are.

The key term here is 'regular place of work'. It means a usual or normal place where the employee starts and finishes their work duties with a particular employer. So, travel expenses incurred by employees travelling from home to, say, clients' business premises which are not their usual/normal place of employment, are tax deductible.

There are a few exceptions to the general rule, such as transporting bulky equipment; on call and standby arrangements; travel between home and a regular work location where duties have substantively commenced at home and are completed at the regular work location; and the travel between home and work location is part of employment duties.

Employers reimbursing or paying for employees' transport expenses must firstly consider the Fringe Benefit Tax (**FBT**) implications, as this may constitute either expense payment fringe benefits or residual fringe benefits. Importantly though, if the costs would have been deductible to the employees, then the benefits are exempt from FBT under the Otherwise Deductible rule.

**Accommodation, Food and Drink Expenses**

Accommodation and food and drink expenses are ordinarily private or domestic in nature. However, they are deductible where the travel is work-related and it is undertaken in the course of performing income-producing activities.

The period away from the employee's usual place of residence must be for **relatively short periods of time**. The longer the time away, the more likely the expenses will be treated as 'living away from home' and **not** deductible. The ATO in the draft guidance provides a rule of thumb to distinguish between work-related travel and living away from home.

That is, the ATO will accept that an employee is undertaking work-related travel where the employee:

- is away from their normal residence for work purposes,
- does not work on a fly-in fly-out or drive-in drive-out basis,
- is away for a short-term period being:
    - no more than 21 days at a time continuously, and
    - has a total number of fewer than 90 days in the same work location in one year, and
- must return to their normal residence when their period away ends.

It is welcome news that the ATO has reintroduced the 21-day rule in relation to work-related travel albeit with additional requirements. Nevertheless, the revised rule of thumb will provide certainty to employers and employees on the income tax and FBT treatments of these expenses.

### The Take Away

The new ATO rulings and guidance provide much-needed guidance in this area. Whilst they contain useful information, the application of the general principles may differ for each taxpayer depending on the facts and circumstances. It is recommended that businesses and employees should seek advice from their tax accountants on the potential impacts to their current or future arrangements.

If you have any queries on the new ATO rulings and guidance, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

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## CHOOSING A BUSINESS STRUCTURE

The choice of the most appropriate business structure(s) to facilitate all that is important for an SME often requires the following competing factors to be taken into account:

- Risk issues;
- Growth and succession requirements; and
- Tax management.

Ordinarily when advising on the choice of a structure for a business client, all of the above factors will need to be considered. Importantly, the advisor will need to ensure that the structure has the maximum flexibility to facilitate changing business requirements.

With regard to the three essential issues, the structure should achieve the following broad objectives:

1. **Limit the personal and business risk** associated with the conduct of the business activities;
2. **Facilitate any potential change in ownership** requirements; and
3. **Take account of both the immediate and future taxation implications** of the generation of business profits as well as the exit strategy of the client.

### Risk Issues

If there is a risk factor associated with the business or any part thereof, the choice of entity will often be determined by the entity that provides limited liability or asset protection.

The objective underlying the structure choice is to create an environment that provides protection or limitation of any risk of economic ruin if some unintended business consequence happens. In some instances there may be a need to compromise one factor with another to achieve the preferred outcome.

A company or trust (with a corporate trustee) is better suited in these instances to provide risk containment, because generally they provide limited liability. But the use of one entity may not necessarily be sufficient to provide risk protection.

Risk issues may require the following to be protected and quarantined:

- personal assets; and
- essential business-generating assets.

The need to provide the necessary protection requires a range of strategies, including:

- moving personal assets out of the ownership of the at-risk individual;
- separating business activities from the asset holding entity;
- using an entity that provides for limited liability; and
- using separate entities for businesses with different risk profiles.

Partnerships and sole trading activities expose the personal assets of the participants to business risk.

**Growth & Succession Matters**

In the vast majority of instances, SME businesses are closely held and will be held by you and/or your family. However, if it is envisaged that you will need additional and external equity in the future, the choice of structure should be able to facilitate the introduction of the new equity without causing significant revenue costs.

The objective of the choice of structure with regard to this issue is to:

- allow the introduction of new equity participants;
- facilitate employee equity participation; and
- take account of succession planning requirements.

If the business requires future equity, the use of either a company or a unit trust at some point in time is necessary.

Similarly, if the business strategy includes introducing employees, a company or unit trust allows the employees to acquire an interest in the business.

Other points to note are:

- the use of partnerships raises the issue of joint and several liability.
- discretionary trusts are not suitable if external equity is required, and
- Division 7A is an ongoing issue for private companies and for trusts that use “bucket” companies.

**Taxation Issues**

There are two broad objectives that a structure should facilitate in relation to taxation:

- allow the business to manage the taxation impost that arises from business activities; and
- ensure that the exit strategy of the client attracts whatever taxation concessions that are available.

To a large extent the matters that need to be considered with regard to business structuring naturally flows from the objectives being sought by you and the issues discussed above.

Whilst these three factors are important in establishing a business structure, they should be regularly considered throughout the life of a business, as it is often the case that circumstances change to require the business to be restructured to better support the efficient operations of the business.

If you require assistance on structuring or restructuring your business, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

### MARGIN SCHEME VALUATION METHOD

Usually, sales of commercial property, vacant land and new residential premises are likely to be taxable supplies and therefore subject to GST. If certain conditions are met, the GST margin scheme is an option of working out the GST payable.

Where GST is usually 10% of the value of the supply, if the margin scheme can be applied, the amount of GST on the supply is 1/11th of the **margin** for the supply.

Generally, the margin for the supply is the amount by which the consideration for the sale exceeds the consideration for the acquisition of the property. *(Note: Consideration for the acquisition of the property excludes the costs incurred in developing the property, such as subdivision costs.)* However in certain circumstances, the margin can be the difference between the amount of the consideration for the supply and the value of the land in an approved valuation as at a particular specified date.

The margin is not the profit margin, (that is, it is not the accounting profit margin). The margin on the sale excludes costs incurred to develop the new property or subdivide the land, as well as stamp duty and other related costs to purchase the property.

Essentially, the main issues in the calculation of the "margin" on which GST is payable will be:

- What is the appropriate" value" of the property to be used; and
- On what "specified date" does the seller use as the value of the property.

The method you can use will depend on when you originally purchased the property you are selling. Where the property being sold under the margin scheme was originally purchased **on or after 1 July 2000**, you can only use the consideration method.

Under the consideration method, the margin is the difference between the property's selling price and the original purchase price. If the property being sold under the margin scheme was originally purchased **before 1 July 2000**, you can calculate the GST payable using either:

- the consideration method; or
- the valuation method.

If you are using the valuation method to sell property under the margin scheme, you must use an approved method of valuing the property. The three valuation methods considered acceptable (depending on the circumstances) by the Commissioner are:

- an approved valuation (*obtained from a Licensed Property Valuer);*
- a valuation based on the payment the seller receives under a contract of sale (if the contract was entered into before the valuation date); or
- a valuation prepared by a state or territory department for rating or taxing purposes.

The approved valuation must provide the market value of the property as at a specified valuation date. Generally, the valuation date for the property is either:

- 1 July 2000 – if the property was held or owned before 1 July 2000 and you were registered (or required to be registered) for GST at that date; or

- The date the seller was registered (or required to be registered) for GST, if the seller held or owned the property before 1 July 2000 and was not registered (or required to be registered) until after that date.

Even though the seller must obtain an approved valuation of the property as it was at *the valuation date (eg. The market value of the period as at 1 July 2000)*, it is not a requirement that the valuation process also be conducted on that date. That is, you can obtain an approved valuation now, for the market value of the property as at 1 July 2000.

Each development or property transaction is unique. Where a seller is eligible to apply the margin scheme, the value of the property for the purposes of calculating the margin is crucial in determining the GST payable (if any). Failure to apply the above rules correctly may lead to an incorrect calculation of the margin, potentially resulting in the ATO imposing penalties and interest charges where GST has been underpaid.

We recommend that any issues in this regard be determined **prior** to the lodgement of the BAS in which the sale of the property is disclosed, rather than when the ATO conducts a review. This provides businesses and their advisors more confidence in the GST payable reported on the BAS and mitigates the occurrence of the ATO delving further into all the details of a subdivision or development to obtain further assurance that the GST has been treated correctly.

If you require further assistance in this regard, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.