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Alternative Structures for Business and Investment

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Abstract
Perhaps the most profound change to Australia's tax system in recent years has been the implementation of a broad-based capital gains tax in Part IIIA of the Income Tax Assessment Act. many receipts which would not formerly have been assessable as income on ordinary concepts under s 25(1) are now within the compass of the Act. There is a need to examine the tax effectiveness of different business structures in their treatment of capital gains, and this is the focus of the first part of this paper. Other more traditional considerations are also explored in detail.

Keywords
taxation, capital gains tax, Australia, business structures

ALTERNATIVE STRUCTURES FOR BUSINESS AND INVESTMENT

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Perhaps the most profound change to Australia's tax system in recent years has been the implementation of a broad-based capital gains tax in Part IIIA of the Income Tax Assessment Act. Many receipts which would not formerly have been assessable as income on ordinary concepts under s 25(1) are now within the compass of the Act. There is a need to examine the tax effectiveness of different business structures in their treatment of capital gains, and this is the focus of the first part of this paper. Other more traditional considerations are also explored in detail.

Introduction

Taxation is a consideration which should be foremost in the minds of all solicitors and other professionals involved in giving commercial advice. Even the most straightforward conveyance can give rise to profound revenue law consequences. It is of paramount importance to obtain complete and accurate instructions from clients to enable a comprehensive assessment of a proposed transaction. Advice should be practical and proactive.

A primary matter to be considered will be the selection of an appropriate business or investment structure. This is a task which has perplexed entrepreneurs, investors and their advisers for many years now. The avalanche of new legislation in recent years has not simplified the tax system or that selection process.

In recent times, trust structures with their attendant flexibility of distribution have been favoured by most notwithstanding legislative initiatives to restrict their attractiveness by, for example, introducing Division 6AA increasing the tax rates on unearned income of minors. However, the introduction of capital gains tax, the imputation system, and other legislative initiatives have raised a number of fresh considerations in choosing a business structure.

Working assumptions

This article is limited to the tax treatment of Australian businesses, and investments owned by Australian residents, as these are the most likely to be encountered in practice. Different and complex considerations apply to businesses and investments with an international flavour. A basic knowledge of the different structures under consideration—sole proprietor, partnership, proprietary company, discretionary trust and unit trust is assumed. Comments relating to trusts assume that the trustee is a proprietary company unless the contrary is stated.

The objective of the paper is to compare the tax effectiveness of competing structures viewed in isolation. Therefore, the possible use of service entities, or of more than one structure either in combination or in tandem, has been ignored. There are many tax planning opportunities in this regard, but their exploration would obfuscate the comparison of base structures.

Comparison of investment structures—capital gains effectiveness

Assume the following facts in relation to an asset:

Acquired 1.7.88	\$200,000
Sold 1.7.90	\$400,000
Indexed cost base as at 30.6.90	\$250,000
Actual capital gain \$400,000 − \$200,000 = ...	\$200,000
Taxable capital gain \$400,000 − \$250,000 = ...	\$150,000

Sole proprietor

The sole proprietor has a taxable capital gain of \$150,000. The liability for capital gains tax is the amount of tax payable on one fifth of the taxable capital gain (ie \$30,000) at the taxpayer's marginal tax rates, multiplied by five. This 'averaging' will benefit the sole proprietor whose income is less than \$50,000 (the current cut-in for the maximum marginal rate of 48%) in the year in which the capital gain is derived.

Assuming the sole proprietor has other income of \$25,000, the amount of capital gains tax payable in the above example would be:

CGT = 5 x (tax of \$55,000* − tax on \$25,000)
= 5 x (\$18,557 − \$5,207)
= \$66,750

*\$25,000 + 1/5 x \$150,000 = \$55,000

Partnership/joint ownership

Capital gains tax is calculated at the partners' level on their fractional interests in partnership assets, and not at partnership level (see IT 2540). Each of the partners, assuming a two person equal partnership, will have a taxable capital gain of \$75,000, and the capital gains tax payable by each will be the tax on one fifth of the taxable capital gain (ie \$15,000) at the taxpayer's marginal rates, multiplied by five.

If each of the partners has other income of less than $50,000 per annum, the capital gains tax will be less than that payable by the sole proprietor with the same level of other income.

Assuming each partner has other taxable income of $25,000, the amount of capital gains tax payable by each partner is:

CGT = 5 x (tax of $40,000* − tax on $25,000)
= 5 x ($11,457 − $5,207)
= $31,250

Therefore the total capital gains tax payable by the two partners is $31,250 x 2 = $62,500.

* $25,000 + 1/5 x $75,000 = $40,000

Discretionary trust

If the taxable capital gain is distributed equally to husband and wife, the same amount of capital gains tax will be payable as in the partnership example assuming the same amounts of other income. However, the discretionary trust allows greater flexibility where:

1 The husband and wife have differing amounts of other taxable income—a larger distribution can be made to the spouse with the lower other taxable income, thus possibly reducing the overall amount of capital gains tax.

2 Distributions can be made to children, particularly those over 18 years of age with no other income. For example, $25,500 of the capital gain could be so distributed, and the beneficiary with no other income would pay no capital gains tax—the amount payable would be the tax on one fifth of the capital gain ($5,100), ie, nil, multiplied by five, which is still nil.

Company

Taxable capital gain	$150,000
Tax liability @ 30%	$58,500
Profit available for distribution to shareholders:	
Actual capital gain	$200,000
Less tax	$58,500
	$141,500

The balance in the franking account is—

$$\$58,500 \times \frac{61}{39} = \$91,500$$

If the whole of the profit is distributed to shareholders, they will only receive imputation credit in respect of $91,500, so that the $50,000 being the 'indexation component' is taxable in the hands of the shareholders

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when distributed to them. That will be so whether the distribution is made at the time of the gain or on liquidation. The benefit of indexation of the cost base is therefore lost on distribution of the indexation component.

Unit trust

The situation will be similar to that for a partnership, assuming equal unit holding by two natural persons.

Section 160ZM provides that where a non-taxable distribution is made to a unitholder in respect of post 19 September 1985 units, the indexed cost base of the units to the unitholder is reduced by the amount of the non-taxable distribution. Any distributions in excess of the unitholder's cost base are taxable capital gains.

In the above example, if the whole of the capital gain was distributed to two equal unitholders with post 19 September 1985 units, the cost base of the units to each unitholder would be reduced by $25,000 (ie, one half of the $50,000 untaxed indexed component).

To overcome the effect of s 160ZM as far as possible, unitholders should contribute funds to a unit trust by way of subscription for units rather than by contributing loan funds, to maximise the cost base of the units.

Conclusion

The discretionary trust, where otherwise appropriate, is the preferable vehicle for 'capital gains type' investments. A unit trust is to be preferred over a company, although non-taxable distributions still reduce the indexed cost base of the units to the unitholder. Nevertheless that is preferable to total assessability of unfranked distributions by companies.

In the case of low risk investments, partnership or joint ownership is preferable to a company based on tax considerations alone. It may also be preferable to a discretionary trust when establishment and ongoing costs are considered and flexibility of distribution is not required—a cost benefit analysis is necessary in each case.

COMPARISON OF BUSINESS STRUCTURES—GENERAL INCOME TAX CONSIDERATIONS

Assumptions

The following table sets out the authors' calculations of the amount of tax payable by a sole proprietor, partnership, proprietary company and discretionary trust on business income, before proprietors' salaries or superannuation of $50,000, $100,000 and $200,000 respectively. To arrive at these figures assumptions have been made which are designed to reflect what may very loosely be described as a 'typical' situation. The effect of varying some of those assumptions is then discussed.

The assumptions are:

1 The Medicare levy has been ignored.

2 The relative costs of administration of the different structures (accounting, Corporate Affairs' fees etc) have been ignored.

3 The family unit in respect of the partnership company and trust consists of husband and wife, both 40 years of age, where one spouse works in the business full-time and the other on a restricted part-time basis only (eg, bookkeeping at home) and has no other income.

4 The husband and wife have equal equity in the partnership and company.

5 No children or others receive distributions of income.

6 The business does not involve 'personal exertion' income of the type referred to in *Tupicoff v FCT* 84 ATC 4851 and the doctors' cases *(FCT v Gulland; Watson v FCT;* and *Pincus v FCT* 85 ATCC 4765) and income tax rulings IT2121 and IT2330.

7 No salaries have been allowed for in calculations for the sole proprietor or partnership—they do not affect the calculations.

8 Superannuation of $3,000 pa for the sole proprietor and $3,000 per partner has been allowed for in each income level for those structures. For the 1989/90 year this is the maximum deductible contribution for self-employed persons. However, note the comments at **Superannuation** below regarding the 1990/91 position.

9 For the company and trust (which has a corporate trustee):

(a) $9,588 per annum in wages and $3,000 superannuation has been allowed in respect of the part-time work of, say, the wife at each income level. This wage will support a superannuation contribution of $3,000 by the employer, under the Retirement Benefit Limits (ISC Circular No 10). It is assumed she will retire at age 60;

(b) the following salaries and superannuation have been allowed for the full-time working husband:

Income Level	*Salary*	*Superannuation*
$50,000	$25,000	$5,950
$100,000	$35,000	$8,330
$200,000	$50,000	$10,995

The superannuation components, paid by the employer, accord with the maximum contributions set in the Retirement Benefit Limits published by the Insurance & Superannuation Commission in Circular No 10. Presume the husband is 40 years old, with 25 years to retirement and that the fund is currently earning 10% per annum and does not have more than 10% in 'in house' assets. Presume also that the husband has no prior superannuation.

10 The net present value of future benefits of superannuation contributions has been ignored—obviously these are much higher for companies and trusts than for the other structures.

11 1989/90 tax rates apply.

The following table sets out the calculations of the tax payable in each situation. Appendix 1 shows how the figures for the $100,000 per annum income level were calculated for illustrative purposes.

Table of tax payable

Income	*Tax Payable*			
	Sole Proprietor	Partnership	Company	Discretionary Trust
$	$	$	$	$
50,000	14,747	8,074	8,081	7,506
100,000	38,717	29,494	28,132	26,974
200,000	86,717	77,434	73,595	73,582

Observations and comments

1 The discretionary trust would appear superior. The amount of tax payable by the company is higher because the imputation credit attaching to dividends is lost due to the insufficient non-dividend income of the partly employed spouse. Clearly, other non-dividend income is required to absorb any imputation credits.

2 The amount of tax payable in company and trust structures will be equal where shareholders receive sufficient non-dividend income to absorb fully imputation credits—other income might include interest at not more than commercial rates on loans to the company, other investment income, and salaries (if paid by the company at reasonable rates).

3 Where the Articles of Association of the company provide for different classes of shares with discretion vested in directors as to distribution of dividends between classes, this will provide most but not all the flexibility of a discretionary trust, with the following shortcomings:

- The rights of shareholders are more entrenched than those of eligible beneficiaries—shareholders may be more likely to complain in the event of unfavourable exercise of discretion by directors.
- The directors can only distribute dividends to shareholders. By comparison, the trust deed can provide for wide-ranging classes of beneficiaries without having specifically to name all possible beneficiaries. New shareholders can only be introduced by allotment or transfer of shares, and the 'transitional' provisions of s 160ZZS must be watched to ensure that there is no change in majority underlying interests, thus rendering pre-CGT assets then subject to capital gains tax.
- In this regard practitioners need to be conversant with IT Rulings 2363 and 2340.

4 The discretionary trust will be even more beneficial than a company or other structure where:

- Distributions are made to minors—up to $416 per annum can be distributed tax free.
- There are children over 18 years of age with no other income, perhaps children undertaking full time study—the taxation benefits are then considerable; however the trustee must recognize that any income not actually distributed to the beneficiary (and therefore recorded as a loan in the trust books) can be called up by a beneficiary, thus possibly causing liquidity problems at a later date.
- The post-CGT business assets including goodwill are appreciating in value at a rate greater than the Consumer Price Index. The indexation component of the capital gain in a company is taxable when distributed to shareholders, as we have seen in the investment example above.
- The trust is a primary producer. Section 157(3A) of the Income Tax Assessment Act 1936 provides that a beneficiary of a discretionary trust will be deemed to be a primary producer provided the beneficiary receives a distribution of at least $1,040 from the trust. It may be possible to obtain large tax savings in circumstances where a child receives income through the trust during the several years leading up to that child's attaining the age of 18. From that date it is then possible for the trustee to distribute a large sum of primary production income on which tax will be averaged with the previous year's low income.
- Complete flexibility is desired with respect to possible income distribution.

5 A company may be favoured over a discretionary trust where:

- The research and development concessions of the Income Tax Assessment Act 1936 are to be sought. These are available only to companies and are presently being phased out. Note that distributions of the benefit to shareholders will be unfranked, and so the concession will ultimately be 'lost'.
- If there is a likelihood that the business will seek further capital from a stock exchange listing at some point in the future.
- All shareholders have sufficient other income to absorb imputation credits, use of a company may provide timing benefits with respect to payment of tax—discussed below.

6 Generally, the trust structure is taxed at a lower rate than the partnership in the example due to the higher tax deductible superannuation contributions.

Timing of payment of income tax and provisional tax

Companies have a clear advantage over other structures. From the 1989/90 tax year, companies will be required to pay a company tax instalment 15 days after the company's relevant balance date. This instalment will be 85% of the company's notional tax liability being either 85% of the company's tax liability for the previous year of income, or 85% of the company's estimate of its actual tax liability for the year of income in question.

The balance of tax owing will be due by the fifteenth day of the ninth month after the balance date for the year of income. Based on the Treasurer's announcements, it would appear that with new companies or companies having no taxable income in the previous year, the company will be required to calculate and pay the whole of its tax liability by the fifteenth day of the ninth month after the company's balance date (in most cases, 15 March of the succeeding calendar year). The August 1989 Budget caused consternation in the accounting world. Of particular concern is the impractical deadline for the first (and principal) instalment of tax. Taxpayers electing to estimate their actual tax liability for the year in question will be penalised if they underestimate by more than 10%. Given the brief interlude of only 15 days in which to calculate the liability, the imposition of penalties may be seen as draconian.

Nonetheless, the system of company tax instalments represents a significant advantage over the provisional tax system applying to non salary income from trusts, partnerships and sole proprietors. For 1989/90 provisional tax is payable by quarterly instalments in respect of non-salary income exceeding $8,000.00. In other words, under the provisional tax system individuals pay tax on non-salary income by instalments during the year in which the income is derived.

The fact remains that companies pay tax in arrears where provisional tax is paid in advance. Planning opportunities based on the time of tax liability may include:

1 Sale of a business or income-producing property to a company, to obtain the benefit of a tax deferral. By using the rollover provisions of s 160ZZN, this can be done without affecting the capital gains tax position of the assets involved, but the transaction will probably be subject to stamp duty, and so a cost-benefit analysis should be undertaken. The loss of the benefit of indexation on distribution of the indexation component to shareholders must also be considered.

2 Alternatively, it may be possible for the trustee of a discretionary trust to distribute income to a company if the terms of the trust deed are sufficiently wide to contemplate such corporate beneficiary (as will be the case with most modern trust deeds) and there is some commercially sound justification for so doing—eg, funding a risky venture where limited liability and protection of other trust assets are sought.

Superannuation

In the past the availability of tax deductible superannuation concessions tended to favour company and trust structures above sole proprietors and partnerships. Tax deductible contributions to funds made by employers were limited only by the Reasonable Benefit Limits (RBLs) whereas the tax deductible contributions by self employed persons were limited to $3,000. The recent budget announcements indicate that this will change substantially from 1 July 1990. The result should be a more fair and equitable entitlement to tax deductible superannuation concessions across each of the different structures.

Self-employed persons will be able to claim superannuation contributions to the full extent allowed by the RBLs, which will be fully deductible except to the extent of 25% of the amount of any contributions above $3,000. The RBLs have been revised with a minimum base salary of $25,000 and have been indexed to movements in Average Weekly Ordinary Time Earnings. This allows all employees to contribute to a maximum lump sum of $175,000 or a pension of $18,750 per annum regardless of the actual salary received. This will be especially advantageous where spouses are paid small salaries for administrative assistance provided to a business. It provides a benefit not only in the sole proprietor or partnership situations but also in a company or trust where partly employed spouses receive relatively small salaries.

Whilst the RBLs provide the maximum funding that will be allowed on the various salary levels, it is unlikely that the full extent of such funding will be undertaken by the various structures. Whilst it is advantageous to consider the taxation benefits, such benefits can only be received where the business or individuals are able to fund the full contribution allowed by the revised superannuation rules. In most cases the financial needs of the individuals and the business will dictate the amount that can reasonably be contributed to the superannuation funds regardless of what taxation benefits may be available. These changes should be borne in mind. However, they are unlikely to substantially affect the comparison of the business structures.

OTHER CONSIDERATIONS

The foregoing commentary has considered the relative merits of the different structures having regard to:

1 capital gains tax;

2 income tax;

3 flexibility of distribution of income;

4 timing of payment of tax and provisional tax;

5 superannuation.

This paper now considers other matters which should also be borne in mind in selecting the appropriate structure. A broad overview of some of the foregoing tax features, and other considerations, is given in Appendix 2.

Complexity of structure

Ease of understanding

The concepts of sole proprietorship and partnership are easily comprehended. Some clients have difficulty with the concept of a company being a separate legal entity, and the introduction of a discretionary trust with a corporate trustee can lead to further confusion, with its distinction between separate legal and beneficial ownership of the assets, and the added complication that the trust is not a separate entity at law, as is a company. Unfortunately, there are still some cases where financiers are reluctant to advance funds to trusts. However, such instances are becoming less frequent.

Establishment

A sole trader needs to comply with few formalities in establishing a business. All partnerships should be constituted by a written partnership agreement, with careful consideration given to matters such as the consequence of a partner's death (which terminates a partnership in the absence of agreement to the contrary), pre-emption arrangements in the event of termination of the partnership for whatever reason, and so on.

Fortunately, the age of technology has meant that acquiring a shelf company and establishing a discretionary trust can now be a relatively speedy exercise, although still more involved when compared with the other structures.

Ongoing administration

The reporting requirements and other formalities for sole proprietors and partnerships are few, as they are for a discretionary trust with natural persons as trustees.

The directors of a company are required by the Companies Code to maintain a registered office and various registers, lodge annual returns, notify the Corporate Affairs Office of changes to offices bearers etc and hold annual general meetings. Directors' duties are becoming more complex. Discretionary trusts with corporate trustees must comply with the same formalities as for companies, and the trustee must also adhere to the terms of the trust deed.

Costs

As is to be expected, the cost of establishing and maintaining each structure is directly proportional to its complexity. These costs should be carefully considered in choosing the appropriate structure.

Another important cost which must be taken into consideration for companies and trusts are employee on-costs such as payroll tax and workers compensation, resulting from the proprietors of the business being employed by a company and being paid salaries for superannuation purposes.

Limited liability

A sole proprietor is, naturally, liable for all of his or her own debts. Partners are jointly and severally liable for all partnership debts to an unlimited extent.

A company enjoys the benefit of limited liability, but such benefit is eroded by factors such as:

1 The insistence of most financiers on personal guarantees of directors and, possibly, shareholders of private companies,

2 Section 556 of the Companies Code, which renders directors and others taking part in the management of a company personally liable for debts incurred by the company where there are reasonable grounds to expect that the company will not be able to pay all its debts as and when they become due,

3 Provisions of various Acts, including, for example, the Crimes (Taxation Offences) Act which render directors knowingly involved in the commission of an offence by a company liable for that offence.

Losses

There are definite benefits to a sole trader or partnership where losses are likely to be incurred during the establishment phase of a business or where an investment is negatively geared. Such losses are available to the sole proprietor or partnership (pursuant to s 92(2)) to be offset against other income in the same year. Losses incurred by a company or trust cannot be distributed (except for group companies referred to below), and are locked in to be offset against other income in the same year, or, if there is none, future profits.

Section 80 of the Income Tax Assessment Act 1936 permits the carry forward of a company's losses for seven years, subject to the company being able to satisfy the continuity of ownership test in s 80A, or the same business test in s 80E.

No such restriction in relation to carry forward losses exists for trusts; however Part IVA of the Income Tax Assessment Act 1936 may apply where trust losses are sold or absorbed using artificial means. The grouping provisions of the Act permit the transfer of losses between group companies (with 100% common ownership) in the same or a subsequent year of income.

Payments to associated persons

Sole proprietors and partnerships should be aware of s 65, which provides that payments to associated persons (widely defined) are allowable deductions for the sole proprietor or partnership only to the extent to which the Commissioner considers that such payments are reasonable. The onus will be on the taxpayer claiming the deductions to establish that the claims are commercially justifiable. Common sense dictates that adequate records should be kept, in the case of wages for example, of the hours worked and duties performed, that the wages be paid regularly, and that the recipient had control over the amounts so paid.

Sections 108 and 109 of the Income Tax Assessment Act 1936 have recently been given extra teeth by the legislature—their application has been extended to include associates. Section 108 provides that any loan to an associated person (again widely defined) which, in the Commissioner's opinion, is a distribution of profits will be deemed to be a dividend paid to such associate as if the associate was a shareholder of the company. The dividend is deemed to be unfranked, and therefore taxable in the hands of the associate.

Section 109 provides that payments by a private company to associated persons for remuneration or on termination of employment which are, in the Commissioner's opinion, excessive, will not be deductible to the company and will be deemed to be an unfranked, and therefore taxable, dividend in the hands of the recipient. Sections 108 and 109 do not apply to trusts.

Fringe benefits tax and substantiation

Sole proprietors and partners cannot receive taxable fringe benefits as no employment relationship exists. It seems to be generally accepted that provision of fringe benefits and payment of fringe benefits tax can in some cases provide a financial advantage compared to deductions which can be claimed by sole proprietors and partners under the substantiation provisions. This is particularly the case for motor vehicles with high private usage. Companies and trusts which can employ the entrepreneurs may therefore enjoy a benefit over sole proprietors and partnerships in this regard. Each case should, however, be considered on its own merits and comparative calculations made.

Alteration to equity and restructuring

The company is certainly the most convenient vehicle where several alterations to equity are anticipated. Shares can easily be transferred or allotted. Stamp duty on transfers will be payable at the relatively low rate of 0.6% on the consideration actually paid for the transfer of the shares, based on the net assets of the company. A substantial amendment to the Stamp Act (Qld) in 1988 means that the duty on transfers of shares representing a relevant interest in a landholding company will now be assessed at much higher progressive ad valorem rates. The amendment is designed to combat what the Commissioner perceived to be a stamp duty avoidance technique where the shares in a landowning company were sold rather than the land itself.

Be aware of s 160ZZS of the Income Tax Assessment Act 1936, inappropriately named a transitional provision, which provides that where there is a change in the majority underlying interests of an asset, pre-CGT assets will be deemed to have been acquired after 19 September 1985.

Section 56C of the Stamp Act (Qld), which has also been amended recently, provides that a disposition (defined to include transfer, allotment, cancellation etc) of shares in a corporate trustee of a discretionary trust will be assessed at ad valorem rates as a proportionate transfer of the gross value of the assets of the trust.

Addition of eligible beneficiaries to a trust by way of amendment of the trust deed will probably constitute a resettlement, such that ad valorem duty is payable on the gross assets of the trust. The discretionary trust deed should be drafted to contemplate the addition of beneficiaries by other means. Stamp duty is payable at ad valorem rates on assignments of interests in a partnership.

If a restructuring is proposed the rollover provisions of the capital gains tax legislation, s 160ZZN and following, allow some relief from capital gains tax where assets are sold to a company in exchange for shares in or securities of that company, where the vendor is immediately after such sale the beneficial owner of all shares in or securities of that company. The capital gains tax status of the assets involved is preserved, and the shares or securities issued as consideration are deemed to have the same capital gains tax status as the assets transferred. The rollover provisions do not apply to transfers to natural persons or discretionary trusts.

It is possible in partnership rearrangements where there is at least 25% continuity of ownership to defer income tax on the sale of trading stock (s 36A) and depreciated assets (s 59AA) until the ultimate sale of such assets to third parties. It is common where such elections are made for some allowance to be made between vendor and purchaser for the tax liability which is, effectively, assumed by the purchaser.

Winding up

Winding up a sole proprietorship is of course quite simple, and winding up a partnership is relatively simple. Liquidating a company can be a timeconsuming and expensive exercise. Normally a discretionary trust will be more easily wound up, and, provided there is no deficiency in trust assets for which the corporate trustee will be liable, it will then be a relatively simple matter to wind up the corporate trustee, provided also that it has not traded in its own right.

As noted above, the indexed portion of any capital gain is effectively taxed on distribution to shareholders, whether on winding up or earlier. The same applies for other tax concession obtained by companies, such as research and development concessions, and building depreciation allowances under Division 10D.

Conclusion

There is no hard and fast rule that can be adopted in determining the most suitable structure for a trading business or for a property investment. The decision depends upon a number of variables such as future property growth (both income and capital), level of gearing, foreign involvement and sale prospects.

The dividend imputation system has gone a long way towards providing parity between those wishing to invest or carry on business through companies and trusts. A tendency seems to be developing for professional advisers to direct clients towards companies ahead of trusts. The advent of so-called 'discretionary' companies has been one important development. A detailed cost/benefit analysis must be carried out on each occasion, and a decision can only be made in the light of all factors relevant to the particular client.

The prudent practitioner will ensure that the structure selected for a new venture is compatable with existing structures and family arrangements. This may entail consultation with other professional advisers.

More than ever before, clients need the protection of competent professionals experienced in giving advice on revenue law matters. Those involved in general practice must be alert to possible revenue law implications of their decisions. Where necessary specialist advice should be obtained.

APPENDIX 1

CALCULATIONS OF TAX FOR EACH STRUCTURE

Income—$100,000 before wages and superannuation

1 Sole Proprietor

Income		$100,000	
Less Super		3,000	
Tax on $97,000 is —			$38,717

2 Partnership

Income		$100,000	
Less Super ($3,000 each)		6,000	
		$94,000	
Income per partner		47,000	
Tax on $47,000 is —	14,747		
Tax for both partners —			$29,494

3 Company

Income			$100,000
Less Super:			
Working spouse	8,330		
Partly employed spouse	3,000	11,330	
Salary:			
Working spouse	35,000		
Non working spouse . .	9,588	44,588	55,918
Taxable Income			$44,082
Tax at 39%			17,192 . . (1)
Leaves amount available for dividends			$26,890

Tax payable by Shareholders:

		Working Spouse	Non-working Spouse
	Salary	$35,000	$9,558
Add	Dividend (half of $26,890)	13,445	13,445
Add	Imputation Credit $\left(13{,}445 \times \frac{39}{61}\right)$	8,596	8,596
		$57,041	$31,599
	Tax	$19,536	$7,775
Less	Imputation rebate	8,596	8,596
	Tax payable	10,940 . . (2)	Nil
Total tax payable:			
(1)		17,192	
(2)		10,940	
			28,132

4 Discretionary Trust:

	Income	$100,000
Less	Salaries and super (as for company)	55,918
	Taxable income	$44,082
Optimum Distribution—		
	Non working spouse	$34,762
	Working spouse	$9,320

Tax payable—

	Working Spouse	Non-working Spouse
Salary	$35,000	$9,558
Distribution	9,320	34,762
	44,320	44,320
Tax:	$13,487	$13,487
Total tax is $13,487 + $13,487 =		$26,974

APPENDIX 2

BROAD OVERVIEW OF TAX AND OTHER CONSIDERATIONS

1 Partnerships

(a) Advantages

- Gains are dealt with in accordance with each partner's tax position. They may be dealt with in the manner most desirable to each partner.
- An excess of deductions over assessable income is fully deductible against income from other sources.
- Income splitting.
- Passing on to partners of foreign tax credits.

(b) Disadvantages

- Unlimited liability.
- Limited superannuation benefits in the 1989/90 year of income.
- Partners are taxed at their personal rates of taxation rather than at a fixed rate (as for companies).
- Potential liability to taxation exists on every admission, retirement or death of a partner.

2 Companies

(a) Advantages

- Fixed tax rate of 39%.
- Fixed low rate of stamp duty on share allotments on transfers except in respect of some landowning companies as defined in the Stamp Act.
- Assets can be transferred to companies using rollover provisions (s 160ZZN).
- Tax advantages to shareholders receiving franked dividends.
- Establishment of the employer/employee relationship to maximise superannuation contributions. Note, however, that self employed persons and employees who are not members of an employer sponsored scheme will be in an improved position from 1 July 1990.

(b) Disadvantages

- No tax free threshold level (39% applies to all income).
- Losses are trapped and cannot be passed on to shareholders.
- Profits from foreign sources are effectively assessable in the hands of shareholders upon distribution.
- The 'sheltered' capital gain (ie, the indexed component) is taxable in the hands of shareholders upon liquidation.

3 Trusts

(a) Advantages

- A discretionary trust has flexibility of distribution of income to beneficiaries.
- The $5,100 tax free threshold may be effectively used more than once reducing the tax payable by Australian resident adult natural persons.
- Establishment of the employer/employee relationship for superannuation. The same caveat applies as above.
- Distribution of certain capital reserves to beneficiaries of a discretionary trust or unit trust may be tax free.
- Passing on to beneficiaries the benefit of foreign tax credits.
- Except for public trading trusts, gains are not trapped and may be dealt with in accordance with beneficiaries' tax positions.

(b) Disadvantages

- Losses (including capital losses) are trapped in the trust and cannot be passed on to beneficiaries.
- Take-over, reorganisation or substantial asset purchases may render assets acquired before 20 September 1985 subject to capital gains tax.
- If there is no trust net income, imputation credits attaching to any franked dividends received by the trust are lost.
- No rollover relief in Part IIIA for assets transferred between trusts.