EFFECTIVE TAX STRUCTURES

Key Factors To Consider When Choosing A Structure

There is a range of factors to be considered when choosing a structure and these will vary according to each case. It is important to collect all the information necessary to ensure that all the relevant factors are considered.

It is often difficult to adopt a structure that will suit all the needs of the client. Therefore, it is necessary to determine which are the most important factors for the client and choose the structure that best suits their needs. Both the advantages and the disadvantages of the structure chosen should be clearly explained to the client – preferably in writing.

More weight should be placed on four key factors.

Asset Protection

Asset Protection can take two forms:

- Protection of the assets of the owner; and
- Protection of the assets of the venture

You should at this stage, ensure that the client is aware of the Bankruptcy Rules in relation to:

- Transfers of assets for less than market value;
- Provision of services for less than market value; and
- Transactions to delay, defeat or hinder a creditor's claim

Income Tax Minimisation

Income tax minimisation can take the form of ensuring that income derived by the structure is taxed at the lowest possible rate.

Ensuring the maximum amount of deductions can be claimed is also important.

When considering income tax minimisation, both the application of the general anti-avoidance provisions ("Part IVA") and the Personal Services Income ("PSI") legislation should be considered.

Capital Gains Tax Minimisation

If the venture is to derive income that is capital in nature, the main way that capital gains tax (CGT) minimisation can be achieved is by structuring a venture so that both the CGT 50% discount and the small business concessions can be accessed.

Ease of Administration

Any structure put in place will give rise to costs. Such costs include but are not limited to:

- The cost of purchasing the entity;
- The cost of initial registrations;
- The costs of ongoing renewals; and
- The cost of accounting and tax return requirements

Other Factors To Consider When Choosing A Structure

In addition to the four critical factors listed above, certain other factors may influence the choice of structure:

Active Income or Passive Income

Active income is income from a business. If the structure is to be used to derive active income, it is likely that more importance will be placed on asset protection, income tax minimisation, ease of administration and accessing the CGT small business concessions.

Passive income is income from investment activities e.g. rent, interest, royalties and dividends. If the structure is to be used to derive passive income, it is likely that less emphasis will be placed on asset protection and more will be placed on minimisation of CGT liabilities. As passive income is being derived, accessing the CGT small business concessions will not be an issue.

Legal and other requirements

In some instances, it may be necessary, for legal reasons, to choose one structure over another. For instance, medical practitioners in South Australia are not permitted to trade through a trust.

It is not uncommon for business clients to dictate what type of structure is adopted.

Ease of Understanding

It is imperative that the business owners understand any structure that is put in place. This is important both for the owners' peace of mind and to ensure the structure is properly administered.

Significant tax consequences can arise if the client does not understand what can and what cannot be done with a structure e.g. Division 7A, Section 109XB, or Non-Complying status of a Superannuation Fund.

Adaptation to Change

Changing market conditions and changing legislative provisions can require that a structure be altered in a small way, or changed completely. Where possible a structure should be able to adapt to any currently foreseeable changes.

You should consider:

- The potential tax implications of changes – e.g. trust resettlements;
- The structure's ability to utilise rollover provisions;
- The ease with which the structure's governing documents can be amended; and
- The costs involved

Admission of Equity Participants

Some structures are more suited to the introduction of equity participants than others. At the beginning of a venture, information should be gathered on whether it is expected that equity participants will be introduced in the future.

In a discretionary trust, it is difficult to introduce an equity participant, as there are no fixed entitlements. Hence, a unit trust may be a better option.

Borrowing Capacity

In general, the more complex a structure is the more nervous a financier will be to lend to it. A structure for instance, that limits a lender's capacity to recover a debt will find it very difficult to raise finance.

Control

You may need to consider who will control the income and assets of the structure and how this control can be changed.

The issue of whether income, ownership and responsibility will all vest in the same people is important.

Succession Planning / family involvement

If a venture is to be sold later, consideration should be given to the ability to sell the structure tax effectively as well as the ability to sell the assets of the venture. In some instances, it may be more advantageous to sell an interest in a structure than the venture itself because of CGT implications.

A structure might also be intended to enable control of the venture or investment to be passed down through successive family generations.

Superannuation Contributions

Superannuation is an effective savings vehicle due to its concessional taxation treatment. Making superannuation contributions is a more attractive proposition when immediate benefits can be gained by claiming a tax deduction.

Minimisation of other taxes and costs

Payroll tax and Stamp Duty are two major taxes affecting businesses. Other major costs can include:

- Workers' Compensation
- Superannuation Guarantee contributions for employees and
- Leave entitlements

Stamp Duty and Land Tax are two major taxes affecting investments.

The Role & Impact of Tax Reform On Choice Of Structure

There have been a number of tax reforms over recent years and many of these will impact our structuring options.

Some of the reforms that are considered are:

- Goods and Services Tax;
- PAYG Tax Instalments;
- 50% CGT discount and small business CGT concessions;
- Non-commercial losses;
- Alienation of Personal Services Income;
- Transfer and recoupment of Company Losses;
- Consolidations Regime;
- Simplified Imputation;
- Simplified Tax System;
- General Value Shifting (for non-arms length transactions); and

- De-merger Provisions

Types of Entities or Structures

There are five basic structures to consider:

- Companies;
- Trusts;
- Partnerships;
- Individuals (sole traders); and
- Superannuation Funds

It is possible to combine these basic structures where complex structures are required.

- Business entities plus a Service Trust;
- Licensing of Goodwill or Intellectual Property;
- Pooled Development Funds;
- Business property held by a Trust;
- Unit Trust owned by a Discretionary Trust;
- Partnership of Discretionary Trusts;
- Limited Liability Partnership;
- Individual with an Investment Trust;
- Spouse owning assets;
- Superannuation Fund and Unit Trusts;
- Superannuation Fund as joint owner of property; and
- Superannuation Funds undertaking business transactions.

Part IVA

Any structure or restructure will need to be considered in light of Part IVA and needs to be justifiable on commercial grounds. You should consider whether it is the case that, if the tax benefit was not obtained, would there still be valid reasons for choosing that structure.

Part IVA applies where a taxpayer enters into a scheme where they or someone else obtains a tax benefit because of the scheme and it can be concluded that the scheme was entered into for the sole or dominant purpose of obtaining a tax benefit.

Companies

1. Introduction

Companies are the most commonly used and best-understood structures.

Companies tend to be preferred:

- Where unrelated parties go into business together, so that their relationships with each other are governed by strict rules;
- For business where there is a high degree of commercial or business risk;

- For contractors where the entities they contract with require them to operate through a company;
- Where the Research & Development concessions will be accessed; and
- Where the entity might be listed in the future

Company Structure

One of the main advantages of a company structure is its limited liability. The effect of limited liability is that the liability of the shareholders is limited to any amounts unpaid on their shares. Limited Liability does not extend to Directors who may become liable for company debts in certain circumstances.

When choosing a company as the preferred structure, there are a number of issues relating to the structure that need to be considered. These include:

The Company Constitution

Under the Corporation Act, a company's internal management is governed either by:

The replaceable rules of the Corporations Act; or

- A Constitution; or
- A combination of both

An advantage for companies using the replaceable rules rather than a Constitution is that the rules apply according to their current format in the Corporations Act – they do not have to update their governing document to allow for the current changes in the law.

Who should be the Shareholders

The shareholders are the ultimate owners of the company.

They generally have rights in relation to:

- The receipt of Dividends;
- Voting at members meetings; and
- The return of capital upon winding up

The shareholder's rights will vary depending upon the rights attached to the shares they hold.

What types of Shares should be issued?

The rights of different classes of shares are set out in the company's constitution.

It is common to find:

- Ordinary Shares;
- Preference Shares – preference and redeemable; and
- Class Shares

Ordinary shares usually carry the right to vote equally with other shares in general meetings, to participate equally in dividends, and to participate equally in capital on a winding up. If no other shares are defined in the constitution, all shares will be ordinary shares.

If a company issues preference shares, it is common for them to have rights such as:

- The right to be paid a dividend from profits before any other type of share;

- The amount of the dividends to be paid to be fixed as a percentage of profits, a percentage of the issue price, or a nominal amount;
- The amount of dividends payable each year to accumulate if the amount is not paid (cumulative preference shares); and
- The right of the company to buy back the share (redeemable preference shares).

Class shares are often designated a letter, e.g. ‘A’ class shares; ‘B’ class shares, etc. The company’s constitution sets out their rights to in relation to votes, dividends and capital. Shares with the right to dividends but not to voting or a return of capital are often known as “dividend access shares”.

Dividend access shares are used so that entities can participate in the distribution of profits from a company, even though they are not able to vote in how the company is run. They are sometimes used to stream dividends to a shareholder to the exclusion of other shareholders, but this can cause problems under the Corporations Act, the franking credit trading rules and Part IVA.

Who should be the Directors?

The Directors are the people responsible for the day-to-day running of the company. The shareholders, usually in a general meeting, appoint them. Their rights and obligations are set out in the company’s constitution and the Corporations Act.

Acting as a director is a position of responsibility and, where a director’s actions can be shown to be negligent, they can be held to be personally liable for any losses the company incurs because of those actions. In addition, if the company trades while insolvent or fails to pay certain tax debts, a director can be held personally liable for the debts or taxes (e.g. PAYG Withholding).

If a director is found to be personally liable, their personal assets will be used to pay those amounts. If they have no personal assets, or insufficient personal assets, they will be made bankrupt.

Who should be the Public Officer?

Each company must have a public officer. They are responsible for the performance by the company of its tax obligations and bear personal liability in certain circumstances. It is usual for the public officer to be the company secretary, a director, or the manager responsible for the taxation affairs of the company.

The public officer is subject to the same penalties as the company if it fails to comply with all its obligations under the Tax Acts. The company is jointly liable with the public officer for any penalty imposed on the public officer.

Who should be the Secretary?

The secretary is the company’s chief administrative officer and does not usually exercise managerial powers unless they are also a director. They generally have the authority to enter into contracts connected with the administration of the company and into contracts relating to the sale or purchase of goods in which the company deals.

Proprietary companies are not required to have a secretary. If this is the case, each of the directors is liable for the secretarial function.

Some of the common duties of a secretary include:

- Having a clear understanding of the company’s constitution and the provisions of the Corporations Act as they effect the company;
- Ensuring that the necessary registers required to be kept by the Corporations Act are established and properly maintained;
- Being conversant with the requirements of the Stock Exchange if the company’s shares are listed;

- Organising and attending meetings of the shareholders and directors, including sending out of notices, the preparation of agendas, collecting proxies, and the compilation of minutes;
- Being aware of meeting procedure so they can advise the chairman if the need arises;
- Ensuring that the company's books of account are kept in accordance with the Corporations Act and that the final reports are prepared in the form and within the time prescribed by the Corporations Act; and
- Supervising the preparation of Tax Returns and ensuring compliance with the various taxation laws (e.g. Payroll, Income, GST and Land Taxes)

Taxation Of Income

A company is taxed on its profits at the current tax rate of 30%.

If these profits are distributed to the shareholders in the form of Dividends, the shareholders will pay tax on the Dividends at their normal Marginal Tax Rate. However, the shareholders receive a credit for the tax paid by the company.

You need to consider how this will impact on the shareholders.

Regard has to be paid to the rules relating to Loans to Shareholders. In some circumstances, loans to shareholders will be deemed unfranked dividends in the hands of the shareholders. This effectively results in double taxation of the profits. Section 108 and Division 7A cover these provisions.

Companies are subject to the PAYG Instalments system when remitting tax on their income. Instalment payments are required when the Commissioner has advised a current instalment rate or an instalment amount.

Personal Services Income (PSI) is income that is mainly a reward for the efforts and skills of a particular individual. If income is characterised as PSI, that income is taxable to the person whose skills and efforts it is rewarding regardless of what entity it may be paid to.

Taxation Of Capital Gains

With regard to the taxation of Capital Gains, a company is not able to access the 50% general discount. However, there are a number of CGT small business concessions that can be applied. Careful planning is needed to ensure that these concessions can be maximised and that they will be able to flow out to the shareholders.

The small business CGT concessions consist of the following four concessions:

- The 15 year exemption;
- The 50% active asset concession;
- The retirement concession; and
- The replacement asset rollover

To be able to access the small business CGT concessions in relation to a capital gain that has been made, the following general eligibility criteria must be satisfied:

- The taxpayer making the capital gain must satisfy the maximum net assets value test; and
- The asset must satisfy the active asset test.

If the CGT asset is a share in a company or an interest in a trust there are two additional concepts to consider being:

- The controlling individual requirements; and
- The CGT concession stakeholder requirements

The **Maximum Net Value Asset test** requires that the total net value of the CGT assets held by you and your connected entities at the time of making the gain is less than $5 million. The test considers three groups of assets:

- Your net assets;
- The net assets of your small business CGT affiliates; and
- The net assets of the entities connected with you.

An asset satisfies the **Active Asset test** if the asset was an active asset of yours just before the earlier of:

- When the CGT event happened; and
- If the relevant business stopped being carried on in the last 12 months (or any longer period that the Commissioner allows), the cessation of the business.

The asset must also have been an active asset of yours during at least half of the period, starting when you acquired the asset and ending at the earlier of:

- When the CGT event happened; and
- If the relevant business stopped being carried on in the last 12 months (or any longer period that the Commissioner allows), the cessation of the business.

If you owned the asset for more than 15 years, the requirement for the asset to be active for half the period of ownership instead starts 15 years before the earlier of the CGT event happening and the business ceasing (if the sale occurs within 12 months of the business ceasing unless the Commissioner allows a longer time).

An **asset is an active asset** if you own it and:

- Use it in the course of carrying on a business;
- It is an intangible asset that is inherently connected with a business that you carry on, e.g. goodwill or the benefit of a restrictive covenant; or
- It is used in the course of carrying on a business by your small business CGT affiliate or another entity that is connected with you.

A **share in a resident company is an active asset** at a given time if you own it and the total of:

- The market values of the company's active assets; and
- Any capital proceeds that the company received during the two years before that given time from CGT events happening to its active assets and which the company holds in the form of cash or debt pending the acquisition of new active assets,

is 80% or more of the market value of all the assets of the company.

If you dispose of a share in a company or a unit in a trust, there must be a controlling individual in that entity at the time of the disposal. There does not need to be a controlling individual at any other time.

For companies, an individual is a controlling individual if they hold legal and beneficial interests in shares (excluding redeemable shares) that entitle them to:

- Exercise at least 50% of the voting power in the company;
- Receive at least 50% of any dividends paid by the company; and
- Receive at least 50% of any distributions of capital made by the company.

If you are disposing of a share in a company or a unit in a trust, the people claiming the CGT concessions must be CGT stakeholders.

The CGT concession stakeholders of a company are the controlling individual and their spouse (if the spouse has a legal and beneficial interest in the company).

The concepts of controlling individual and CGT concession stakeholder are used in the specific eligibility criteria for the following CGT concessions:

- 15 year exemption;
- Retirement exemption; and
- Replacement asset rollover

The effect on the shareholders on the distribution of the amounts subject to the CGT small business concessions will depend upon which concessions are accessed.

The 15-year exemption

The amount of the gain sheltered by this exemption can be paid to the shareholder tax-free.

The retirement concession

If the amount is paid to a shareholder, aged 55 or over, as an ETP, the amount will be paid to the shareholder tax-free. The amount of the gain sheltered by this exemption can also be rolled over to a Superannuation Fund (and must be rolled over if the recipient is under 55). It will not be taxed when received by the Superannuation Fund.

In both instances however, the amount will count towards the recipient's reasonable benefit limit (RBL).

The replacement asset rollover

The replacement asset rollover requires the amount of a gain, subject to the rollover, be used in purchasing a replacement active asset. There is no amount that can be paid out to shareholders representing the amount sheltered by this concession.

The 50% active asset concession

On the eventual distribution of amounts sheltered by the 50% active asset concession to shareholders, the amount is subject to top up tax in the hands of the shareholders. This occurs because, on distribution, the amount is an unfranked dividend.

This top up tax can be reduced where the distribution of the amount is left until a company is liquidated, where the amount is paid to a shareholder for the cancellation of their shares and is treated as a capital receipt. The capital nature of the receipt allows he shareholder to access the CGT general discount and possibly the CGT small business concessions, reducing the amount of top up tax.

Distributions

Companies are not required to distribute their profit each year and can retain amounts to fund working capital, to fund expansion of the business, to make additional investments or to repay borrowings.

This is particularly advantageous because the corporate tax rate is only 30%.

The earnings of a company, when eventually distributed, may require top up tax to be paid by the shareholder. If the payment of profits out of a company can be deferred until the shareholders are not receiving any other income, the effective rate of tax applying to the shareholder can be reduced substantially.

Payment of company tax gives rise to Franking Credits. These franking credits are stored in the Franking Account of the company. When the company receives a tax refund, this event gives rise to a Franking Debit, as does the attachment of Imputation Credits to a Dividend.

The balance of the Franking Account indicates the amount of Imputation Credits that a company can attach to a frankable distribution.

A company is able to pay dividends from the current year's profits. A dividend can also be paid from prior year profits where they have not been eliminated by current year losses.

Dividends are based on Accounting profits not Taxable profits.

Dividends may also be paid from certain reserves such as an asset revaluation reserve. However, dividends paid from an asset revaluation reserve are unable to be franked.

Private companies must issue a Dividend Statement within 4 months of the end of the income year. The Dividend Statement must state the following information:

- The name of the entity making the distribution;
- The date on which the distribution was made;
- The amount of the distribution;
- The amount of franking credit allocated to the distribution;
- The franking percentage for the distribution;
- The amount of any withholding tax that has been deducted from the distribution;
- The name of the shareholder;
- Where the distribution is unfranked – a statement to that effect; and
- Where the distribution is franked – the franked amount and the unfranked amount of the distribution

Dividends may be declared on different classes of shares under the Corporations Law (Dividend Streaming). For tax purposes, the payment of different dividends on different classes of shares may attract the operation of the franking credit trading provisions, the franking credit streaming provisions, and Part IVA.

For tax purposes, the benchmark franking rate is determined when the first dividend is paid for the year, regardless of the class of share on which the dividend is declared.

Profits made by a company do not need to be paid to shareholders as dividends in order for them to access the money. The profits may be retained in the company and the money loaned to the shareholders.

However, loans to shareholders of private companies, or associates of the shareholders, can have tax consequences.

Section 108 of the ITAA 1936 applies to loans made to private company shareholders or their associates before 4th December 1997.

Under this provision, a loan made to a shareholder or associate can be deemed a dividend by the ATO if the Commissioner can show that there was no intention to repay the loan at the time the loan was made.

The amount of the deemed dividend is treated as an unfranked dividend paid to the shareholder or associate.

Division 7A applies to loans made by private companies to shareholders or associates after 4th December 1997. It acts in addition to and not in replacement of Section 108.

Under Division 7A, a loan made to a shareholder may be treated as an unfranked dividend, as was the case under Section 108. In addition, a debit can be made to the company's franking account to the extent of the unfranked deemed dividend.

A debit will be made to a company's franking account if:

- The company has a benchmark franking percentage, in which case the debit will reflect that percentage; or
- The company does not have a benchmark franking percentage, in which case the debit will be applied as if the dividend had been fully franked.

Division 7A will apply to a loan made to a shareholder or associate unless:

- The loan is made in the ordinary course of business on arm's length terms;
- The loan is made under a written agreement entered into before the loan is taken out, with a legislated interest rate and repayment term; or
- The shareholder or associate is a company.

Division 7A also applies to payments to or on behalf of shareholders and associates as well as the forgiveness of debts owed by them.

Losses

Generally, any losses made in a company structure will be quarantined within the entity and can only be carried forward to be offset against future profits. In order to use these losses, the company must pass either the continuity of ownership or the same business test.

In order to pass the **continuity of ownership test**, shares carrying more than 50% of all voting, dividend and capital rights must be beneficially owned by the same persons at all times during the test period.

The test period runs from the start of the loss year to the end of the income year.

Even if the company fails the continuity of ownership test (COT), it can deduct prior year losses if it can pass the same business test (SBT). This test consists of four parts:

- The **same business test**: The company will pass the SBT where the same business is carried on by the company throughout the same business test period (being the whole of the income year) as was carried out immediately before the test time (being the time when the COT was failed);
- The **new business test**: The company will fail the SBT if it derives assessable income in the year of income from a business of a kind that it did not carry on before it failed the COT;
- The **new transaction test**: The company will fail the SBT if it derives assessable income in the year of income from a transaction of a kind that it had not entered into in the course of its business operations before it failed the COT;
- The **anti-avoidance provision**: The Company will fail the SBT, where it had started a new business or entered a new transaction before it failed the COT, for the purpose of being taken to have carried on the same business as it carried on immediately before it failed the COT.

The commissioner's views on the meaning of 'same' in the same business test are set out in Taxation Ruling TR 1999/9

Refinancing Company Shareholder Loans

A company can refinance its working capital and deduct interest on the replacement borrowings.

It does not matter whether or not the loans being refinanced bore interest at a greater or lesser rate than the replacement borrowings. Often when a company is formed, the owners of the company will loan money to the business as well as seeking funds from outside financiers. As the company grows, it will be easier to access external finance.

Repaying shareholder loans may enable the shareholder to use the resulting funds to repay private non-deductible borrowings.

Succession Planning

Planning for succession in a company requires dealing with both shareholdings and directorships. Companies can be used to manage a gradual passing of control between generations by the older generation (the original shareholders) appointing the younger generation as directors to work in the company. As time passes, the older generation can resign as directors and leave the running of the company to the younger generation.

Many methods can be used to pass shares held by the older generation to the younger generation:

- They can be purchased, which will lead to CGT liabilities, but there may be access to the 50% general discount and the small business concessions;
- They can be gifted, which will have the same CGT consequences as them being sold;
- They can be left to the younger generation through a will which will defer the CGT consequences until the shares are sold by the younger generation; or
- They can be left to a testamentary trust with the younger generation being in control of the testamentary trust and with the ability for income to pass through to minor beneficiaries to be taxed at adult rates.

The shares would not need to be passed across at all if they were originally held by a discretionary trust. In that case, control of the company could be passed by passing the control of the trust.

General Value Shifting

Prior to 1st July 2002, there were special rules that applied to stop shareholders from shifting value between shareholdings.

This might occur when a company:

- Issues shares;
- Buys back shares; or
- Changes dividend or voting rights

Such value shifting was known as "**Share value shifting**" and only applied to entities with an interest in a company.

From 1st July 2002, a general value shifting regime has replaced the former share value shifting measures. The general value shifting rules apply equally to entities with interest in either companies or trusts.

The general value shifting measures:

- Apply to transactions between commonly controlled entities that do not occur at market value (companies and trusts);
- Require adjustments to carrying values of equity and loan interests that are held, directly or indirectly, in those entities; and
- Include safe harbours, exceptions and a choice of adjustment methods that ensure the measure is properly targeted at significant value shifts.

Consolidations Regime

The consolidation regime was introduced with effect from 1st July 2002. Companies do not have to notify the ATO as to whether or not they will adopt the system until they submitted (or submit) their 2002/2003 tax returns.

The consolidation regime allows corporate groups to be taxed as single entities with one tax return being lodged. In limited instances, trusts can form part of a consolidated group.

Not taxing a group as a single entity has meant that, the corporate groups have had to account for all intra-group transactions and intra-group (equity and debt) interests.

From 1st July 2003, the following provisions were repealed and equivalent provisions are only available to entities that form part of a consolidated group:

- Loss transfers between companies that are part of the same wholly owned group;
- CGT rollover relief for asset transfers for companies that are part of the same wholly owned group; and
- The inter-corporate dividend rebate for franked and unfranked dividends paid between companies that are part of the same wholly owned group.

To be eligible to enter the consolidations regime, there must be a head company and at least one subsidiary member.

The head company must:

- Be an Australian resident company (and not a prescribed dual resident);
- Not be a subsidiary member of another consolidated group or of a group that is eligible to consolidate; and
- Have at least some of its taxable income taxed at the corporate rate.

The subsidiary member must:

- Be a company, trust or partnership;
- Be wholly owned directly or indirectly by the head company;
- Meet the same residency requirements as the head company; and
- Have at least some of its taxable income (if any) taxed at the corporate rate (for companies only).

There are special rules that allow groups of foreign owned subsidiaries without a head company in Australia to group for consolidation purposes.

Costs of consolidation include:

- There will be a cost of entering the consolidations regime such as legal and accounting fees, changing accounting systems, educating staff on the system, etc.; and
- In the 2002/2003 year, consolidated entities may find their ability to utilise transferred losses restricted because of complex loss factor calculations

Benefits of consolidation include:

- Continued access to the loss transfer measures after 1st July 2003;
- The ability to include some trusts within the group for the purpose of loss transfers;
- Being able to access rules which make it easier to carry forward and transfer losses than under the rules that apply to individual companies;
- Not triggering capital gains tax when assets are transferred between group members after 1st July 2003;
- Not triggering income tax when unfranked dividends are paid to group members after 1st July 2003;
- Simplified reporting – one tax return is lodged and one PAYG instalment rate will apply to the whole group;
- Losses and imputation credits become the property of the head entity and can continue to be used after a subsidiary has been sold; and
- In some instances, assets held by subsidiaries may experience an up-lift in their carrying values for tax purposes.

Debt & Equity Measures

Measures were introduced with effect from 1st July 2001 to enable a company to determine whether investments made in the company should be classified as debt or equity.

The debt and equity tests determine whether a return on an investment in an entity may be frankable and non-deductible (like a dividend) or may be deductible to the entity and not frankable (like interest).

Companies will normally be treated as having issued an equity investment when they issue:

- A share;
- An interest providing returns that depend on the issuer’s economic performance;
- An interest providing returns at the discretion of the issuer; and
- An interest that may or will convert to such an interest or share

unless the equity investment satisfies the debt test at the time of issue.

In order to be characterised as a **debt interest**, five elements need to be present:

- There must be a scheme;
- The scheme must be a financing arrangement;
- There must be a financial benefit received;
- The issuing entity must have an effectively non-contingent obligation to provide a future financial benefit; and

- It must be substantially more likely than not that the value of the financial benefit to be provided will be at least equal to or exceed the financial benefit received.

A common area of an investment in a company that can cause problems under the debt equity measures, are 'at call' loans (e.g. directors and shareholders loans). Commonly, when a business starts, shareholders will subscribe for shares in the company, but also lend money to the company. The money will be loaned without written documentation being prepared, and often with no interest being charged.

Under the debt and equity provisions, an 'at call' loan will generally be classified as an equity interest where:

- There is a loan between a connected entity (e.g. an associate) and a company;
- The loan does not have a fixed term; and
- The loan is repayable on demand by the connected entity.

The debt and equity provisions mean that 'at call' loans made to companies will be treated as equity interests from 1st July 2004 unless something is done to allow them to pass the debt tests. In general if either:

- A loan agreement is put in place requiring repayment of the loan within 10 years; or
- Interest is charged on the loan at a high enough rate that the fifth element of the debt test can be passed
- The loan can continue to be characterised as debt.

If the loan becomes characterised as an equity interest, any interest paid on the loan will not be tax deductible, and will be treated as a frankable dividend.

Winding Up A Company

A company can be either deregistered or liquidated.

Deregistering is relatively cheap and a number of service providers exist who will arrange for the necessary advertising and forms for a reasonable fee.

A number of conditions must be satisfied:

- All members agree to the deregistration;
- The company is not carrying on a business;
- The company's assets are worth less than $1,000 (this means that by this time the company's assets must have already been distributed to members and creditors);
- The company has paid all fees and penalties payable under the Law;
- The company has no outstanding liabilities; and
- The company is not a party to any legal proceedings.

A company ceases to exist on deregistration, but this does not effect any pre-existing liability of the directors – the company's officers may still be liable for things done before deregistration. A deregistered company can be reinstated during a period of 7 years from deregistration.

The liquidation of a company is more expensive than deregistration. A number of steps are involved, and a rigid time frame imposed by Corporations Law.

Liquidation will be preferred over deregistration where:

- The company is insolvent; or
- All the members do not agree to the de-registration

After liquidation, a company is deregistered permanently.

Combinations Involving Companies

Companies tend not to evolve into other entities. Usually, the basic company structure remains in place and other entities or companies are put in place around it.

Some examples are:

- A trust might be added to the structure to hold plant and equipment or property;
- A Superannuation Fund might be added to provide retirement benefits for the owners;
- A joint venture or partnership may be entered into with other entities; and
- Intellectual property may be licensed to another entity.