# Capitalising on trusts and GST concessions

ADAM FISHER*

**This article addresses issues around two of the most talked-about topics relating to family owned businesses – the use of trusts and access to the small business Capital Gains Tax (CGT) concessions – with the aim of giving you a broader understanding of these topics, the associated benefits and how they may be relevant to your circumstances.**

## To trust or not to trust?

A trust is a legal relationship in which one party (the trustee/s) holds property for the benefit of another party (the beneficiaries).

The origin of trusts can be traced back to medieval times in the United Kingdom where 'uses', as they were then called, operated to allow men who went off to the Crusades to legally assign their residential property to another male family member, on the condition that the Crusader's wife continue to live in the residence. This mechanism overcame the inability of women to own property. How times have changed.

In today's terms, a trust allows a separation in property rights between the legal owner (the trustee) and the beneficial owner (the beneficiaries). Practically this often means that bank accounts, share registries and other property registers show the trustee as the owner of the specific trust property, with no mention of the name of the trust or the beneficiaries. Trustees have fiduciary obligations that prevent them from absconding with the trust property and require them to always act in the best interests of the beneficiaries.

In addition to the trustee/s, other parties to a trust are:

- settlor – creates the trust
- appointor – appoints the trustee/s and has the ability to dismiss a trustee from the position
- beneficiary – designated by the terms of the trust to benefit from the income and/or corpus (capital) of the trust property.

Trusts have received attention from the Courts and from the Commissioner of Taxation in recent times. In particular the recent Bamford High Court case has attracted a lot of attention. Do not be scared away from trusts because of this scrutiny. They are still a very effective tax-planning vehicle if managed correctly.

A company or person is treated as a 'legal entity' but a trust is not. However, a trust is a 'taxable entity' and is required to lodge its own income tax return. For tax purposes the trust effectively operates as a conduit, since the trust itself is not liable to income tax. Instead, either the trustee (if the trust is accumulating income) or the beneficiaries (if the trust is distributing income) carry the tax burden.

It is common practice for the trustee to distribute the income generated by a trust because if it is accumulated the trustee generally pays income tax at the highest marginal rate (currently 46.5%). This distribution is rarely done in cash, but rather by journal entry in the trust accounts that creates a right for the particular beneficiary to be paid the distribution amount by the trustee. This amount is called an 'unpaid present entitlement'.

For discretionary trusts this 'distribution mechanism' allows the taxable income to be taxed in the hands of the most tax-effective (lowest-taxed) beneficiary. This flexibility means a discretionary trust is the ultimate tax-planning vehicle.

It is very important that the distribution of trust income be evidenced by documentation in the form of a resolution and minute. This ensures the taxable income of the trust is assessed for income tax purposes as you intend it to be and avoids an adverse tax position.

Examples of effective trust distributions may include:

- interest income distributed to non-resident individuals, limiting income tax to withholding rates
- capital gains distributed to individual tax payers who are eligible to apply the 50% general CGT discount
- fully-franked dividend income distributed to companies, where the imputation credits mean no further income tax will be payable.

For primary-production businesses, holding farming assets in trusts results in benefits including asset protection, the ability to distribute profit to a range of family beneficiaries and the ability to change control and ownership of the land as part of succession planning.

Top five tips for managing trusts:

1. Have the trust deed updated for current circumstances and guidelines including those flowing from the Bamford case.
2. Understand the trust deed, what its limitations are and what powers and discretions are provided to the trustee.
3. Have an idea of what income the trust has derived in a given financial year before June 30.
4. Plan the distribution of income and document that decision via a resolution and minute.
5. Seek professional advice from either a tax accountant or legal advisor.

**While trusts are very effective vehicles, traps do exist and therefore seeking professional advice is always recommended.**

## Small business Capital Gains Tax (CGT) concessions

What would you say if you were told you could sell your farm and farming assets and significantly reduce or eliminate the tax payable on the sale? The small business CGT concessions allow you to do just that.

These concessions apply to businesses with an annual aggregated turnover of less than $2 million or with net assets of $6 million dollars or less. Many primary producers in South Australia fall within this range.

In addition to the general 50% discount available to individuals and trusts, other generous concessions available are

categorised as:

- 50% active-asset reduction
- business rollover
- 15-year exemption
- retirement exemption.

These concessions apply to the 'active assets' of the business.

Active assets are assets that are used in the business, for example goodwill, farming land and business premises. Active assets are distinct from passive assets such as an investment property that receives only rental income.

For these concessions to apply the active assets also need to be CGT assets, so assets such as stock, property improvements, plant and equipment do not qualify.

So, how can we apply these concessions to protect the cash and minimise the tax payable?

### 50% active-asset reduction

This concession is applied first. As long as the capital gain is from the disposal of an 'active asset' there is an additional 50% reduction of the capital gain. Individuals and trusts entitled to the general 50% discount and small-business 50% reduction can effectively reduce their assessable capital gain by 75%.

One of the following concessions is then applied to further reduce the remaining capital gain.

### Business rollover

This concession applies where the proceeds of the sale are used to acquire a new active asset or improve the condition of an existing active asset. The capital gain and the tax payable are rolled over and deferred until the sale of that new asset.

### 15-year exemption

This applies where an asset is held for a significant time and the owners are retiring. To be eligible for this concession the asset needs to have been owned for at least 15 years, the owners need to be over the age of 55 years and the disposal of the asset needs to happen in connection with the owners' retirement. In these circumstances the remaining capital gain is reduced to nil.

### Retirement exemption

This concession applies to owners using the proceeds to fund their future retirement. If the owners are under the age of 55 and make a capital gain they can reduce the gain to nil by contributing the value of the remaining gain to a complying superannuation fund.

If the owners are over the age of 55 there is no requirement to contribute the remaining gain to a complying super fund as long as the proceeds are used for retirement purposes.

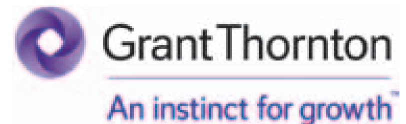
Capital gains disregarded under this concession are subject to a lifetime limit of $500,000.

The small business capital gains tax concessions are especially generous in that they can be applied on top of each other. For example, there may be nil tax payable on a $2 million capital gain as a result of applying the general 50% tax discount, the 50% active asset reduction and the retirement exemption.

Trusts and the small business Capital Gains Tax (CGT) concessions are important but complex areas in the small-business space, so good advice is essential.

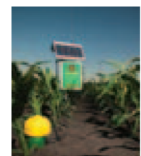
For more information:
Adam Fisher, 8372 6666, 0401 419 102, adam.fisher@au.gt.com

**Adam Fisher is an SA-based agribusiness industry specialist with Chartered Accountant and Business Advisory firm Grant Thornton.*



**Sometimes, it's what you can't see that can cost you.** For instance, you know your moisture levels vary from field to field, but knowing when yield-robbing variances occur isn't as easy to determine. Until now.

**With John Deere Field Connect in-field soil moisture monitoring**, you can instantly see whether your soil moisture levels are balanced. Field Connect uses field-installed probes to monitor moisture levels at various depths. It then sends the information to a web-based interface where you can see the data on your computer or mobile device.



**Without delay or guesswork**, you can make the adjustments needed to protect your yields and reduce costs. It's all part of the advanced solutions and services available through John Deere FarmSight™ and your John Deere dealer.

JohnDeere.com.au/FarmSight