Grant Thornton

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31 October 2012

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Sir/Madam

FAMILY BUSINESS IN AUSTRALIA

I refer to the inquiry which was initiated on 16 August 2012 into Family Business in Australia.

I hereby provide a submission in relation to item 5 of the Terms of Reference, ie:

"5. The role of family trusts in facilitating family businesses"

This submission will concentrate on the practical consequences and implications of the use of family trusts in the family business sector in Australia, rather than the technical factors or the various legalities of trust estates.

Prevalence of Family Trusts in Australian Family Businesses

In this writer's experience, the two legal structures most favoured by family businesses in Australia are companies and trust estates, however the most prevalent structure used is the family trust. This is particularly the case for businesses commenced prior to the late 1970's, possibly due to the (then) existence of death duties (see further below).

Companies are often used in conjunction with a family trust, most commonly to act as the trustee of the trust, due to the limitation of liability afforded by a company structure; thereby providing a degree of protection for the business assets which are being held in trust, as well as the personal assets of the family members, which would potentially be exposed should those individuals act in the capacity of trustee. In this situation, one or more family members would normally be shareholders and directors of the trustee company.

In my experience the most common type of family trust used is a discretionary trust, whereby the trustee has the discretion to distribute income and/or capital of the trust to one or more beneficiaries in amounts or proportions as the trustee sees fit; as opposed to a fixed or unit trust, where each beneficiary has a pre-determined right to receive a fixed proportion of the income and/or capital of the trust.

Why Family Trusts Are Popular With Australian Family Businesses

Family trusts have traditionally been popular with family businesses in Australia for a variety of reasons including the following:

1. **Avoidance of Death Duties**: prior to their abolition in the mid-to-late 1970's, death duties were imposed on deceased estates in Australia. Assets held in a family trust were regarded as being safe from death duties, as a beneficiary's interest in such a trust was not considered to be an asset to be dealt with in the deceased person's estate, and therefore could not attract death duty;
2. **Protection of Business Assets from Breakdown in Family Relationships**: keeping family assets within a discretionary trust structure is seen as providing those assets with a degree of protection against the breakdown of marriage or de facto relationships of family members, because family members do not own an asset as such, they merely have a contingent expectation of possible future distributions of income or capital. Former spouses or partners therefore face a more difficult task in staking a legal claim over such assets in a separation or divorce proceeding;
3. **Simplification of Estate Planning**: founders of family businesses may use a family trust, which potentially carries on holding the business assets following the death of the founder, to simplify estate planning. This may be particularly the case where a founder has difficulty deciding which of their children should inherit those assets, and in which proportions;
4. **Keeping Family Involved in Ownership**: holding business assets in a discretionary family trust creates a natural difficulty for the family members who are the beneficiaries of the trust to deal with their individual interest in those assets; the family members are generally unable to buy or sell their contingent interest in the trust assets. This means that the family unit (subject to the discretion of the trustee) must make a collective decision to hold or sell those business assets. For many business founders, this is an attractive feature of a family trust, in that it defeats any temptation for individual family members to sell their interest in the family assets, which would potentially dilute the family's ownership. For many business families, a trust ownership structure is the glue which binds the family to the business for this reason;
5. **Taxation Benefits**: the following taxation benefits of family trusts are commonly recognised –
    a. **Tax minimisation via income splitting:** the trustee of a discretionary family trust is potentially able to obtain a tax advantage for the family unit by distributing income to beneficiaries on lower marginal tax rates; and
    b. **Reduction/Deferral of Capital Gains Tax:** under current taxation rules, any taxable capital gains earned by a the beneficiaries of a family trust is afforded the same general 50% discount as would be available to an individual owner; by comparison, if the same assets were owned by a company, taxable capital gains are not eligible for the 50% discount.

Examples of Family Trusts in Practice

Family businesses operate under a trust structure for a variety of reasons, including those suggested above. By way of illustration, the following are actual examples of situations I have been directly involved in as an adviser to the families in each case:

1. **Family A Trust:** this discretionary family trust is the ultimate shareholder of a group of subsidiary companies, each of which conducts a separate & identifiable part of the family business operation. Each company declares a dividend to the trust shareholder each year. The trustee of the trust makes distributions of this dividend income to the family member beneficiaries, at its discretion. The trust also pays certain personal expenses of the family members, such as car expenses and household bills. The trustee of the trust is a company, the sole shareholders & directors of which are the founder and his wife. The family is currently considering

how and when the control of the trustee company should be transferred to the family's children, who are now all adults.

2. **Partnership of Family B and Family C Trusts:** this partnership of two discretionary trusts was formed in 1973 to acquire the assets of a fifth generation Australian family business. The trusts represent the two remaining branches of the original family owners who started the business in the late 19th century. The trusts share a common company trustee. The shareholders and directors of the trustee companies are representatives of each family branch, therefore each family has a measure of control and influence over the other family's ownership interest in the family business. The trusts were formed deliberately in this manner in order to encourage both branches of the family to remain in business together, however in recent years tension has arisen between the two families and this arrangement is unlikely to continue.

Recent Developments & the Future for Family Trusts

In recent years this writer has seen more family assets being owned in a company structure, which for new businesses is now as prevalent if not more prevalent than family trusts. Despite the relative advantages of family trusts outlined above, I expect the trend away from family trusts to continue for the following reasons:

1. **Statute of Limitations**: trust estates have a legal limit of 80 years after which they are legally required to vest (ie be wound up). By comparison, a company can exist indefinitely;
2. **Portability of Ownership**: many family businesses now consider it to be commercially desirable to have the ability to sell part of the business to a third party, or for family members to hold their ownership interest in other than equal shares. These outcomes are far more difficult in a trust structure as opposed to a company structure;
3. **Family Law Challenges to Trusts**: the concept that contingent interests in family trusts are "immune" from potential family law claims is now less certain than previously following a number of court challenges; and
4. **Ongoing Scrutiny re Taxation Advantages**: over the past ten to fifteen years, the perceived favourable taxation treatment of trusts and trust beneficiaries has been the subject of a raft of legislation, taxation pronouncements and public commentary in Australia. As a result, scrutiny of the use of trust estates can be expected to continue, and possibly increase to a point where continued use of a family trust as a legitimate business structure for holding family assets may no longer be viable.

I would be pleased to assist further should your Committee consider it useful for me to do so.

Yours faithfully
GRANT THORNTON AUSTRALIA LIMITED

Robert Powell
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