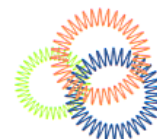


Tax issues (and opportunities) affecting franchisees



Franchise Alliance

In the previous edition we discussed how the construction of your franchise and the description of it in the Franchise Agreement can have a direct bearing on the franchisee's tax effectiveness. This article takes a look at alternative business structures & how this decision can assist in the franchisee's tax effectiveness. The same logic also applies to franchisors.

Business Structure

Before buying a franchise (or in the franchisor's case commence operation as a franchisor) the franchisee should seek expert advice to determine which structure is best for their particular (personal & business) circumstances. This relates to both during the operation of the business and the proceeds upon its eventual sale – ie: begin with the end in mind

The main items to consider together with the 5 main types of business structures are shown in the diagram below.

For an individual or family to protect their personal assets (eg family home) the franchisee should consider being either a company or a trust with a corporate trustee. A franchisee owning and operating their business as a sole trader, partnership or trust with an individual as trustee is putting their personal assets on the line.

NB: It should be noted it is normal for both the franchisor & the banks to require personal guarantees – although the banks are now lending a % over the assets & undertakings of many franchised businesses, normally at a higher interest rate.

By way of explanation a Fixed (Unit) Trust is normally used when non related parties enter into a joint venture (eg: 2 families buy a franchise together), the unit-holding representing their % ownership and therefore distribution of profit. The Discretionary (Family) Trust is where a family buys a franchise, the trustee having the ability to distribute profit at its discretion. In order to maintain the flexibility for distribution of income and preserve the 50% CGT concession as explained below in the case where two families buy the franchise together it is commonplace for the beneficiaries of the Unit Trust to be Family Trusts.

There are four main Capital Gains Tax (CGT) concessions available to small business, one of them being a 50% discount for individuals and trusts (incl. partnerships of these). A company therefore does not receive this discount however may

qualify for one of the other three. In addition, all the above entity types are taxed on only 50% of any profit on Goodwill, however with a company this tax free income is stuck inside the company.

Using the example in September's edition if the business goodwill is sold for \$415,000, a company would be taxed on \$200,000 of this (unless the transaction can be grouped with one of the other three CGT concessions), however in the case of a family trust with a single beneficiary the beneficiary would be taxed on \$100,000 only.

Therefore where asset protection, succession planning & income splitting requires the use of an entity to purchase & operate a business, a trust (or even a partnership of trusts) can be preferable to a company. A corporate beneficiary can be included to keep income from being taxed excess at more than the corporate tax rate.

NB: Care must be taken in the year of a capital gain to distribute all income & capital to individual controllers in order to access the CGT concessions

Summary

Whilst there are many ongoing tax issues for franchisees the above are considered as essential tax planning strategies for both the franchisee and the franchisor.

NB: These notes are intended as a guide only. You should not act solely on the basis of the information contained in this article because many aspects of the material have been generalised and the taxation laws apply differently to individual people based upon their particular circumstances. Further, as taxation and other related laws change frequently, there may have been changes to the law since this article was written. Do not act on the information contained in these notes without first obtaining specific advice from a tax professional regarding your particular circumstances.



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ENTITY	ASSET PROTECTION	CAPITAL GAIN 50% DISCOUNT	CGT CONCESSIONS (2)	INCOME SPLITTING
Sole Trader	x	✓	✓	x
Partnership	x	✓	✓	✓
Trust – Fixed & Discretionary				
Individual trustee	(1)	✓	✓	✓ Disc
Corporate trustee	(1)	✓	✓	x Fixed
Company	(1)	x	✓	x

(1) If certain conditions are met

(2) Subject to meeting CGT concession conditions