

NEWSLETTER



ASHBY ROMA & CO
CHARTERED ACCOUNTANTS • MANAGEMENT CONSULTANTS

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MANAGING YOUR SUCCESSION

The taxation issues of succession planning have changed markedly since the 1970's when there were both Federal and State Death Duties and Gift Duty (as well as Stamp Duty) to contend with. These taxes provided healthy incentives to plan the intergenerational transfer of assets well before the death of the proprietor. They also provided a strong incentive to use entities with perpetual succession to hold property (these are entities which survive after the death of the proprietors such as trusts and companies). But despite the abolition of death duties and gift duties, there are still good reasons to manage your succession carefully.

On 19/09/85 capital gains tax (CGT) was introduced applicable to sale or transfer of land and other assets acquired after that date. It should be said that in the face of accusations that CGT was a surrogate death duty, the Government of the day avoided imposing CGT on death and instead imposed it on the succeeding sale of the asset.

Thus, stamp duty, capital gains tax and income tax are now the primary **taxes** for consideration along with social security issues, when establishing a succession plan.

But taxes are not the only reason for succession planning. There are issues of business management, equity and personal satisfaction.

In relation to business management for example, what is the profit foregone from failing to transfer or share managerial control with younger more innovative and energetic personnel? What is profit foregone from avoiding change?

In tackling this issue other questions arise. How do current proprietors transfer business assets fairly between their children? At what stage in the lives of existing proprietors and at what stage in the lives of the children do you make the change? To what extent do the retiring proprietors need to secure their future into old age?

These are the issues. The following is a check list of questions which need to be considered.

MANAGEMENT AND EQUITY ISSUES

- 1) What is more important, equity between children or business continuity at all costs in favour of those children continuing in the business, farming or otherwise?
- 2) To what extent is business viability threatened by taking funds out of the business to provide equity to those who do not wish to participate in it? eg. How much should the farmers sons and daughters who wish to leave the business, be entitled to?

- 3) To what extent is business viability threatened by an increased number of proprietors eg. Several farmers sons wishing to return to the land?
- 4) To what extent can the business afford to invest in off farm assets to provide retirement income for retired principles or can the business afford to support retirees from business income eg. can a retired farmer be funded by his farmer children after handover? The problem with this of course is that retirement often coincides with periods of increasing lifestyle demands including education of grandchildren leading to a conflict of interest between children and their retired parents. Some non business institutional investments (eg. off farm assets) will go some way to easing this conflict.
- 5) Can the provision of institutional (eg. Superannuation) investments meet the dual objectives of providing retirement funding for parents as well as provide a legacy for sons and daughters not continuing in the business?
- 6) To what extent can social security benefits such as aged pension be accessed in retirement? This may provide valuable additional income in some circumstances, particularly for a surviving spouse who's high spending years are behind them.
- 7) Has the option of sharing or transferring managerial control irrespective of whether the proprietary interests are transferred been considered? e.g. sons could come into partnership with increasing managerial control without transferring land.
- 8) Have the issues been discussed between the parties?
- 9) Over what time period should any planned transfers be implemented?

In family situations, the issues remain to be negotiated with sound reason and common sense in the interests of all. In this day and age reasonable equity between children and adequate provision for parents personal needs in retirement may be a preferred approach to facilitating business continuity at all costs, but each situation is different. However each generation needs to make their own way in the world and some will do it better than others. Leaving the farm for example to a favoured member of the family does not guarantee success and does not guarantee succession beyond the next generation. There are many examples where entrepreneurial managers succeed with limited capital and little or no inherited wealth. Courts may also get involved where distributions under a Will are not equitable.

TAXATION & LEGAL ISSUES

- 1) Will Capital Gains Tax be a problem?

The capital gains tax issue rests on the value of business net assets and business turnover. Essentially if assets are less than \$6m, or turnover less than \$2m, capital gains tax should not be a major issue as there are retirement exemptions and rollover provisions in respect of "active" business assets (farming land etc) although your business structure will need careful review to ensure you comply with the exemption provisions. If net assets are greater than \$6m and turnover greater than \$2m capital gains tax could be a problem and will affect the method and timing of execution of any estate plan.

2) Will stamp duty be payable on any transfers?

With State stamp duty rates now at 5-5% on amounts greater than \$500,000 this is a most important tax. Existing intergenerational transfer exemptions allow business assets including land to be transferred from parents to descendants stamp duty free. Transfers pursuant to a Will are also free of stamp duty. Transfers from a Trust to a personal beneficiary are likewise free of stamp duty (except for a nominal duty, usually \$10). Thus a properly designed succession plan, should be able to minimise this tax in most cases.

3) Who owns the assets, individuals, a company or trust?

For family and taxation reasons, land is often held in trusts and sometimes in companies. Clearly the holding entity affects the nature of transfer of ownership – e.g. transfer of control of a trust by changing the trustees would be an effective method of transferring effective ownership of trust held assets. Likewise transfer of shares in a land owning company would effectively transfer land ownership (but beware of land rich companies where share transfers can be subject to real property stamp duty rates and intergenerational exemptions do not apply).

4) What are the income tax effects?

Income tax can be a powerful incentive to split income with other business participants and family members. Having capacity to allocate income to the lowest tax rate member of the family can save many tax dollars and Will Trusts can enhance opportunities for this. Does the succession plan provide the flexibility to do this?

YOUR WILL

Where proactive succession planning has been effected, the assets subject to distribution by Will, may have been diminished but nevertheless they will be important, especially in providing for a surviving spouse and sometimes for those descendants not staying in the family farm or business.

With good planning, the surviving spouse may be left eligible for aged pension which may, if they own their own home debt free and have assets to the limit of the pension assets test, be sufficient for them, thereby avoiding the need for further family support.

For high net worth individuals testamentary trusts should also be considered. These are trusts for descendants established in the Will. They can provide descendants with significant income tax and in some cases stamp duty and capital gains tax advantages. They may also provide wealth protection benefits by holding assets safe from actions for default or damages against descendants. If the inherited assets were left directly to the descendants, they could be lost in the event of actions by creditors.

The benefits of a testamentary trust can last for 80 years from the death of the testator. At the same time they are also flexible and can be managed in accordance with the wishes of the beneficiaries (unless the testator wants to limit this flexibility). They are long documents and more expensive than standard Wills but likely to be worth it in many situations.

Infant beneficiaries of Testamentary Trusts receive favoured tax treatment, not subject to the punitive rates on investment income applicable to children generally (until age 18). These benefits can pass to successive generations of children over the life of these Trusts

INSURANCE

A diligent evaluation of the role of wealth protection (life) insurance and income protection insurance should be part of any succession plan.

CONTACT

So there is no set format for succession planning but the foregoing are some of the issues small business and farming families will need to consider if they wish to get it right.

If you would like to discuss any aspects of your succession planning requirements including taxation and equity aspects, insurance, your Will, optimising social security benefits, superannuation requirements, retirements savings plans, investments for retirement, contact our consultants at:

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