



ASHBY ROMA & CO

CHARTERED ACCOUNTANTS • MANAGEMENT CONSULTANTS

WHAT IS SUCCESSION PLANNING?

Disclaimer: This newsletter provides information of general interest to readers but does not constitute specific advice which they should seek independently.

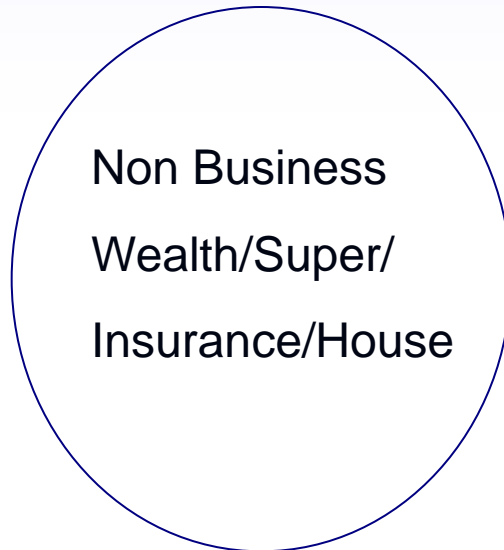
WHAT IS SUCCESSION PLANNING?

- a) Transfer of family assets to children (descendants)
- b) Transfer of business assets to business successors eg. Working sons/daughters/son in laws.
- c) Providing retirement facilities and income for senior family members

But it is more – it is a process by which family members come together to negotiate acceptable outcomes in a harmonious way releasing the frustration often associated with failure to address the issues.

PARTIES TO SUCCESSION

Parents



Children
Generally



Parties to Business
(Working Sons etc)

CLEARLY THE WEALTHIER YOU ARE THE EASIER IT IS. THE MORE PROFITABLE YOU ARE THE EASIER IT IS.

IS THE REAL ISSUE SUCCESSION OR IS IT SUCCESS

STRATEGIES TO ASSIST YOU

1. Developing Strategies For Parties to Business & Children Generally

a) Decide family priorities:

eg. Parents need to consider whether they are prepared to jeopardise business viability to:

a) provide retirement benefits for themselves

b) provide a reasonable (or equal) inheritance for non business siblings.

Don't leave it too late

b) Do the business participants have an additional entitlement due to their participation in the business or have they been properly remunerated during their working life.

c) Are there alternatives where non business family members are happy to participate in the family business as an investor or owner without realising their interest in the business or is this a recipe for disaster?

Are the non business assets sufficient to pay them out eg. Investments, balance of super or insurance, town house etc.

d) Consult The Family Members & Confront The Issues

- Parents need to explain their priorities re income and retirement goals.
- Explain aspirations for both business participants and non business participating children.
- Explore viability issues (may need to encourage children into alternative occupation)

e) Children need to be given the opportunity to:

- Communicate their goals and aspirations as part of the succession planning process.
- To outline strategies by which they consider a satisfactory succession can occur.
- Take ownership of the plan with a view to developing a harmonious business and personal succession.

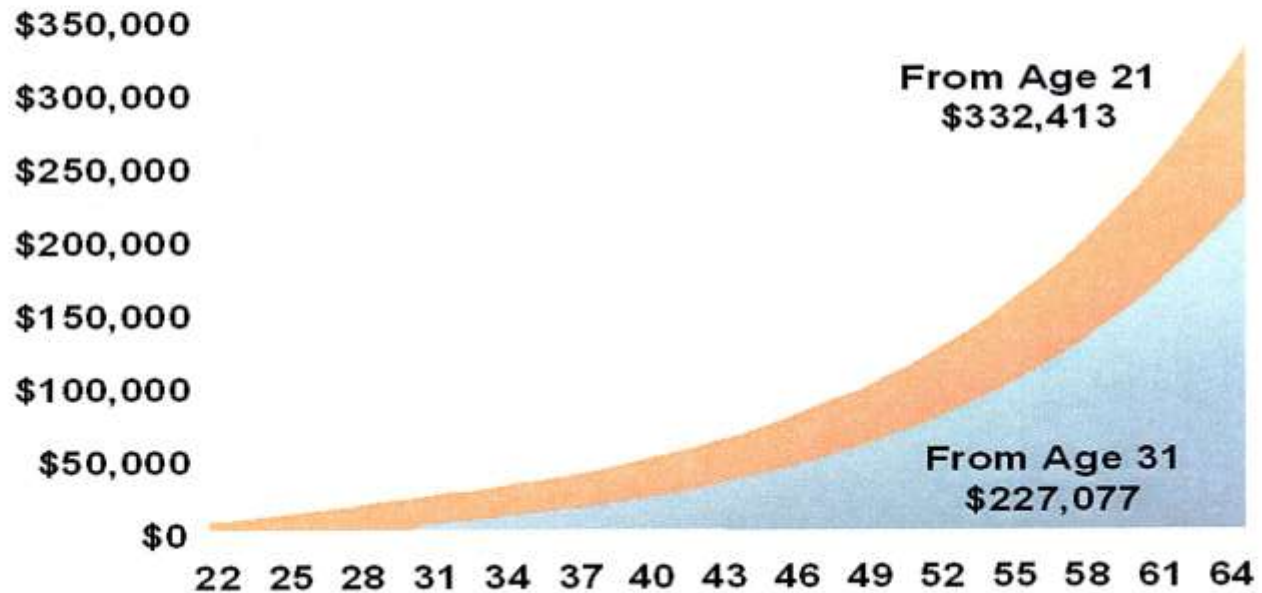
f) Consider how to avoid dissipating family wealth due to family breakdown? (eg. Bloodline trusts)

STRATEGIES TO ASSIST YOU

2. Retirement Strategies

a) Start providing for retirement early.

Wealth accumulation



Assumptions: average return of 8% pa 0% inflation. At 21 years, Initial investment \$5000, yearly investment of \$1000 until aged 30, At 31 years, initial investment \$5000, \$1000 each year until aged 65

- b) Alternatively retire later
- c) Decide if you want to provide for retirement from:
 - business or farm assets or
 - non farm/business assets
- d) If from business or farm assets it would be a reasonable decision to reinvest surpluses in the farm or business on the assumption the farm or business can fund the requirements of:
 - Parents in Retirement
 - Other Siblings not participating in the business
- e) The decision between reinvesting in farm or business or investing in a non business assets (shares, property etc) may depend on – profitability of farm or business investments v's profitability of non business investments.

REINVESTING IN YOUR FARM OR BUSINESS VIA SUPER

A superfund can acquire business real property (land and buildings) This is a strategy predicated & approved by legislation. The land and buildings can be rented back to the business at commercial rent. The rent is a tax deduction for the business and assessable to the superfund at a tax advantaged rate (15%) for accumulation funds or nil rate for pension fund.

If acquiring property already owned by the family, stamp duty and capital gains tax need to be considered. Not an issue if buying additional land and buildings (from outside the family) directly in to the superfund. While a superfund can borrow to acquire assets there are strict limitations and benefits may be marginal – particularly where superfund is in pension phase.

Example

Getting Funds into Super & Tax Benefits from Investing in Business Real Property

SUPERFUND CONTRIBUTIONS:

Modest

Deductible

Father June 30th 2010 July 1st 2010 100,000 (2 x \$50,000 pa)

Mother June 30th 2010 July 1st 2010 100,000 (2 x \$50,000 pa)

200,000

Less: Contributions Tax @ 15% 30,000

170,000

After 2 years (say June 30th 2010 & July 1st 2010)

Undeducted Contributions 4 x 150,000 *1 600,000

Total Contributions \$770,000

Acquire land 940,000

Rent to business say 6% 46,200

Tax deduction value @ 30% 13,860

Assessable @ 15% 6,930

Net benefit p.a. \$ 6,930 *2

Or if pension fund phase nil tax rate, net benefit pa \$13,860 *2

*1 All parties <65 years could add undeducted contributions of \$450,000 each over 3 year period.

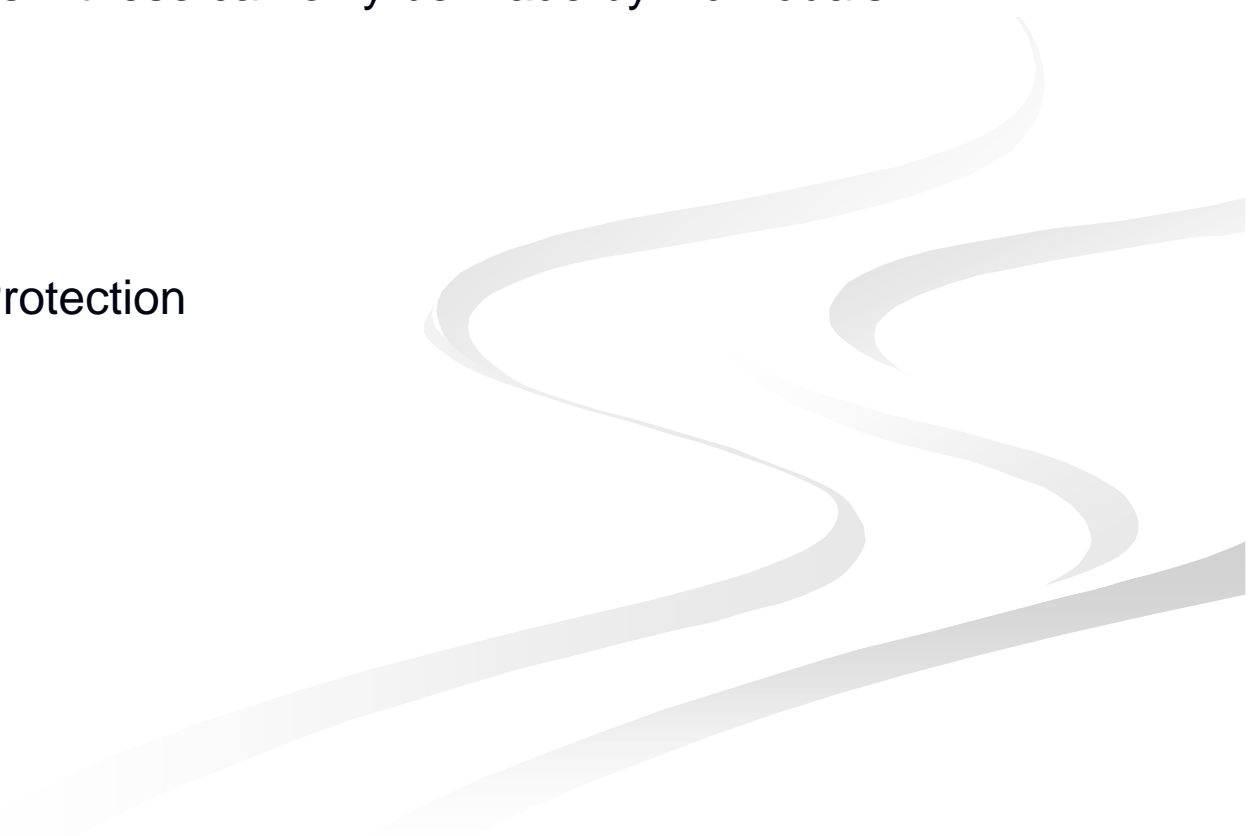
*2 Rent advantage repeats annually.

g) Deductibility of borrowings to make contributions?

Interest of funds borrowed to make undeducted contributions to super will never be deductible. Where employer contributions are made from normal working capital including overdraft, interest will be deductible. Interest on personal deductible contributions made from working capital of a business will generally be deductible. Companies and Trusts cannot make personal undeducted contributions – these can only be made by individuals.

h) Consider insurance:

Term Life
Income Protection
Trauma

A decorative graphic consisting of several thick, light gray wavy lines that flow from the right side of the slide towards the left, creating a sense of movement and depth.

HOW MUCH DO YOU NEED IN RETIREMENT?

For Example:

1. House if relocating say \$500,000
2. Principal sum to provide income
3. Aged Pension If you qualify

HOW MUCH CAN YOU EARN FROM AN ANNUITY *1 OVER 25 YEARS

SUM	EARNING RATE		
INVESTED	6.8%	8%	10%
500,000	39,452	43,369	50,076
750,000	59,178	65,055	75,115
1,000,000	78,905	86,740	100,153

*1 Lump sum is fully exhausted after 25 years

HOW MUCH DO YOU NEED IN RETIREMENT? (continued)

IF YOU WISH TO KEEP CAPITAL (eg to leave to other kids)

Say annual requirement for living \$75,000

Capital Required to Generate \$75,000 p.a. (prima facie)

	<u>EARNINGS</u>	<u>CAPITAL</u>	<u>INCOME</u>
Fixed Interest	6%	1,250,000	75,000
Share Portfolio	4% F/Frnkd = 5.7% after tx	1,315,000	75,000
Property (rent)	6%	1,250,000	75,000

THIS does NOT allow for capital gain expected from growth assets (eg. property or shares) over that period or growth in income from growth assets.

GROWTH CAPITAL GROWTH 25YRS

4%	x 2.67
6%	x 4.29
7%	x 5.43

HOW MUCH DO YOU NEED IN RETIREMENT? (continued)

IF YOU WISH TO KEEP CAPITAL (eg to leave to other kids)

GROWTH	CAPITAL GROWTH 25YRS
4%	x 2.67
5%	x 3.39
6%	x 4.29
7%	x 5.43

Growth in asset values from investment in Growth assets (eg property and shares), will lead to growth in income from these sources so the figure for income above for shares and property, refers only to initial income whereas income from fixed interest investments is likely to remain static.

How long will your savings last?

Rate of withdrawal of principal invested

	7%	8%	9%	10%	11%	12%	13%	14%	15%	16%	17%
10%				∞	26	19	16	14	12	11	10
9%			∞	27	20	18	14	12	11	10	9
8%		∞	29	21	17	15	13	11	9	9	9
7%	∞	30	22	17	14	12	11	10	10	8	7
6%	34	23	18	15	13	11	10	9	8	8	7
5%	25	20	16	14	12	11	10	9	8	7	7

Source: BT Financial Group. No allowance made for inflation, taxation, fees or expenses.

Note: Years have been rounded down to the nearest year.

RETIREMENT SCENARIO'S

What is your Succession Plan

You get to age 65: No spare cash

No non business investments

Sons working in business with lifestyle commitments

Expanding business but high gearing

1. Pension
2. Sell Up
3. Keep Working

Alternatively At Age 45:

Invest \$25,000 pa compound in super – 15% tax. 6.8% and 8.5% after tax return

	<u>6.8% after tax</u>	<u>8.5% after tax</u>
Net at age 65 =	\$642,581	\$787,335
Net at age 70 =	\$984,622	\$1,280,318

Is age pension a viable SUCCESSION STRATEGY?

COUPLES – Own Home

Assets	Full	Part Pension	
	Pension	Perpetuity 5.7%	Annuity 5.7%
Home – 2 Ha	<u>\$500,000</u>	<u>\$500,000</u>	<u>\$500,000</u>
Investments eg Shares	238,000	500,000	500,000
Car	10,000	10,000	10,000
Furniture	<u>10,000</u>	<u>10,000</u>	<u>10,000</u>
Pension Assets	<u>\$258,000</u>	<u>\$520,000</u>	<u>\$520,000</u>
	<u>p.a.</u>		
Pension Income couple \$496.30 p.f. ea	25,808 *3	15,590	15,590
Investment Income eg Shares @ 5.7%	<u>13,566</u>	<u>28,500*1</u>	<u>35,955*2</u>
INCOME p.a.	<u>\$39,374</u>	<u>\$44,090</u>	<u>\$51,545</u>

Pension reduces:

\$39 p.f. per \$1,000 increase in assets over \$258,000 combined Max \$978,000

50¢ p.f. per \$1 of increase in earnings over \$256 pf combined Max \$2,415 p.f. combined (\$62,790 p.a.)

*1 Assumes 5.7% on \$500,000 p.a. perpetuity

*2 Assumes 5.7% on \$500,000 p.a. on 25 year annuity

*3 Full pension \$496.30 pf each

Note: If disposing of assets to reduce investments for pension purposes all assets disposed in previous 5 years are attributable to pension applicant and therefore added to remaining assets for pension calculation purposes.

Is age pension a viable SUCCESSION STRATEGY?

SURVIVING SPOUSE – Own Home

Say aged > 75 years

	Full <u>Pension</u>	Part Pension <u>Perpetuity</u> 5.7%	<u>Annuity 5.7%</u>
Assets	181,750* ⁴	\$350,000	\$350,000
Pension	17,118* ⁵	10,557	10,557
Investment Income	<u>10,360*¹</u>	<u>19,950*²</u>	<u>28,169*³</u>
	<u>\$27,478</u>	<u>\$30,507</u>	<u>\$38,726</u>

*¹ \$181,7500 x 5.7%

*² \$350,000 x 5.7%

*³ \$3500,000 x 5.7% as Annuity absorbing interest and principal over 20 years

*⁴ Assets test max for full pension single home owner

*⁵ Max Pension single person \$658.40 pf

So with capacity to redeem some assets to supplement income from sale of investments and capacity to sell house or reverse mortgage (borrow on house to live) surviving spouse may be ok on this level of inheritance if over say 75 years with low living costs.

WILLS

SPOUSE PROTECTION

- 90% of Wills leave assets spouse to spouse to protect each other.
- Can be absolute or life interest
- Other beneficiaries are residual, eg children etc
- At older ages can reduce dependence on spouse to spouse transfers if social security adequate

Deals with your personally owned assets

Land own name

Partnership Interests

Investments

Loan Accounts

Shares in Companies

Power of Appointment discretionary trusts

- a power in the trust deed allowing the appointer to change Trustees.

Insurance

Superannuation (some circumstances)

Can't deal with

Trust owned assets

Superannuation Assets unless directed to Estate.

Company owned assets (but shares transferrable)

WILLS (continued)

Estate Planning needs to deal with transmission of assets in Trusts Superfunds and Companies.

Transfer Trust owned assets by:

- Change Appointor – via Will
- Change Trustee – prior to death

Transfer Company owned assets by transfer of shares in company.

Superfund Assets transfer by binding nomination and reversionary pension.

- If to non dependant descendant >18 yrs after death - taxed portion taxed at 15%.
- If to superfund member prior to death – then to mature descendant – no tax
- If to spouse or infant dependant – no tax

WILLS

Testamentary Trust

Simply a trust established in a Will.

Can leave each beneficiary their entitlement in a testamentary Trust instead of absolutely.

Advantages

1. Asset protection – separates asset from beneficiary – can have separate trustee
 - protects against debts of beneficiary.
2. Tax advantages:

Infant beneficiaries taxed at normal rates (not penal rates applicable to minors). Distribute up to \$15,000 (10/11) tax free to each grand child then great grand child then great great grand child (possibly). Trust has 80+ year life.

TRANSFER TAXES

1. Capital Gains Tax

Pre 19/9/85 - No CGT on sale

Small Business CGT Exemptions

Small business exemptions apply to “active” business assets if either:

Business Assets excluding house < \$6

Business Turnover < \$2m

Example – Retirement Rollover Exemptions

Sale value to Son	\$1m
Cost	<u>400,000</u>
Capital Gain	600,000
Less: Discount 12 months ownership	(300,000)
Less: Active Asset exemption	(150,000)
Less: Retirement Rollover Exemption	<u>(150,000) *</u>
Assessable Gain	<u>Nil</u>

* *Must be set aside for retirement – if > 55 yrs simply held by you for retirement
- if < 55 yrs must be paid in to Super (tax free)*

TRANSFER TAXES

Retirement Exemption & Rollover Exemptions

1. Capital Gains Tax (continued)

There are other CGT exemptions which apply in the event of retirement (15 year rule) and on sale of an asset and purchase of a replacement asset where CGT can be deferred.

Disclaimer: CGT exemptions are a complex area of tax law and conditions apply to these exemptions

Assets Transferred by Will

No CGT assessed on death, only on 1st sale after death.

Pre CGT assets exempt until Date of Death so CGT for beneficiary starts on date of death. Assets purchased by deceased after 19/9/85 subject to CGT from date of purchase by deceased until 1st sale after death.

TRANSFER TAXES

2. Stamp Duty

Land Transfers – Ad valorem rates

Stamp Duty marginal rates increase from 0 to 5% on amounts up to \$500,000:

At \$500,000 duty is:	\$21,330
Amounts over \$500,000	\$21,330 +5.5%

a) LAND TRANSFERS – Family Farm Exemption

Stamp Duty exemptions allow transfers of farming land and equipment between family members stamp duty free.

Must be a business relationship between transferor and transferee – so can't transfer to non business participant duty free.

Asset must be used in business - can not be an investment property rented out. But land rented from family trust to family business OK.

Can transfer between family Trusts under these rules providing trustees carry on business of primary production.

b) TRANSFER OF WATER RIGHTS

Stamp Duty Free

TRANSFER TAXES (continued)

2. Stamp Duty

c) TRANSFERS PURSUANT TO WILL

Stamp Duty Free

d) TRANSFERS FROM TRUST (eg Discretionary Family Trust) OR SUPERFUND TO BENEFICIARY

Stamp Duty Free

Exemption applies to transfer of superannuation assets in specie to member or beneficiary but not on sale to non member.

e) TRANSFER PRIVATE Co. SHARES

Rate: Normally 60¢/\$100 ie 0.6% - to be abolished 1/7/12 (?)

Land Rich Companies (>80% of value is land) “ad volorem” rates apply as above for land.

f) COMPANY LIQUIDATION (members voluntary)

No Stamp duty on proportional (in specie) distribution of assets from company to shareholders.

SEEK PROFESSIONAL ADVICE – ALL TRANSFER TAXES

Example

Family: Pa Ma Ike Mike & Mary
Pa HAS: **DISTRIBUTE**

EXPLANATION

Farm Land in Family Trust 50% Mike

While Pa alive, transfer 50% to new trust, for, Mike
CGT applies subject to small business exemption. No stamp duty subject to farm transfer exemption.

50% Ike

Existing Trust: Change Trustee to Ike,
If Pa wished to retain control of the assets after transfer he could remain joint Trustee with boys. Ike & Mike and remain appointer of each Trust. He would leave appointorship to boys via will.

Partnership Stock & Plant Ike & Mike

Bring Ike & Mike in to partnership prior to Pa passing on. Assets divided on eventual partnership dissolution.

Shares Investment Co 100% - Mary

Leave shares in investment to Mary in Will, via Testamentary Trust. No CGT implications for investments.

Superfund Business Land 50% Ike
50% Mike

Prior to death, transfer SF land to beneficiary. (Pa & Ma)
Transfer to boys or Trust for boys or testamentary Trust for boys via Will.

Superfund Other Assets 100% Ma

Reversionary pension to Ma. Ma to draw pension assets prior to death and pass to children gift or Will.

The foregoing example is illustrative only and transfer taxes are not dealt with exhaustively. Suggested options will not be optimal in all circumstances.

Seek professional advice – Ashby Roma & Co can assist you