

# Exiting the Business



# & Succession Planning

# Succession Planning

All successful businesses and business people, plan ahead. Peoples' wealth is usually incorporated in their business and often little time is put towards the planning for an eventual exit from the business or the departure of one or more owners.

More often than not, procedures governing the departure of one or more key players in the business have not been clearly defined. The exit of one partner or the sole owner itself is inevitable for reasons such as:

*"So I know all about the ups and downs of football, I know that one day I will be sacked."*  
Jose Mourinho

- Retirement
- Death or illness
- Disagreements or
- Due to other personal reason

Departures can be voluntary or forced, whatever the reason it happens. The need for appropriate agreements between parties defining how it will be facilitated, ensures a peace of mind for the departing proprietor and the remaining party(s).

Succession plans define the components and can be in the form of Buy/Sell Agreements, Exit Agreements etc and needs to take into consideration these basic elements:

- The terms of the exit
- The valuation
- The funding
- The tax consequences

## Buy Sell Agreements

*"The art of progress is to preserve order amid change, and to preserve change amid order."*  
Alfred North Whitehead

All business relationships will inevitably come to an end. The question is when, and in what circumstances. The key to it is to identify the possibilities and plan for the outcome.

Putting legal agreements and funding in place before they are needed is simply good planning to protect what is often a very large investment. The purpose of the written agreement is to record the intention of all parties to the business when the event occurs.

This document should be written in a way that facilitates the smooth transition of the ownership of equity in a business, and ensure this happens in accordance with the way that the parties of the day originally intended. The document may be in various formats that include mandatory buy/sell agreements, put and call options and trusts.

The document needs to stipulate who is to sell and who is to buy a business interest. It should also set out the basis on which the interest in the business is to be valued and the event on which a sale will take place.

A Buy/Sell Agreement typically provides for three main transfer types:

- compulsory sale and compulsory purchase ('compulsory triggering event' such as death & disablement);
- compulsory sale and voluntary purchase ('voluntary triggering event'); and
- voluntary sale

Whatever the reason either compulsory or voluntarily it is important to have an agreement in place.

## Funding the Exit

*"It's not the hours  
you put in your  
work that count,  
it's work you put  
in the hours."  
Sam Ewing*

Commonly when a partner voluntarily leaves, the funding is usually arranged by pre-agreed terms and when someone's departure is caused by death or disablement, the funding is usually via insurance.

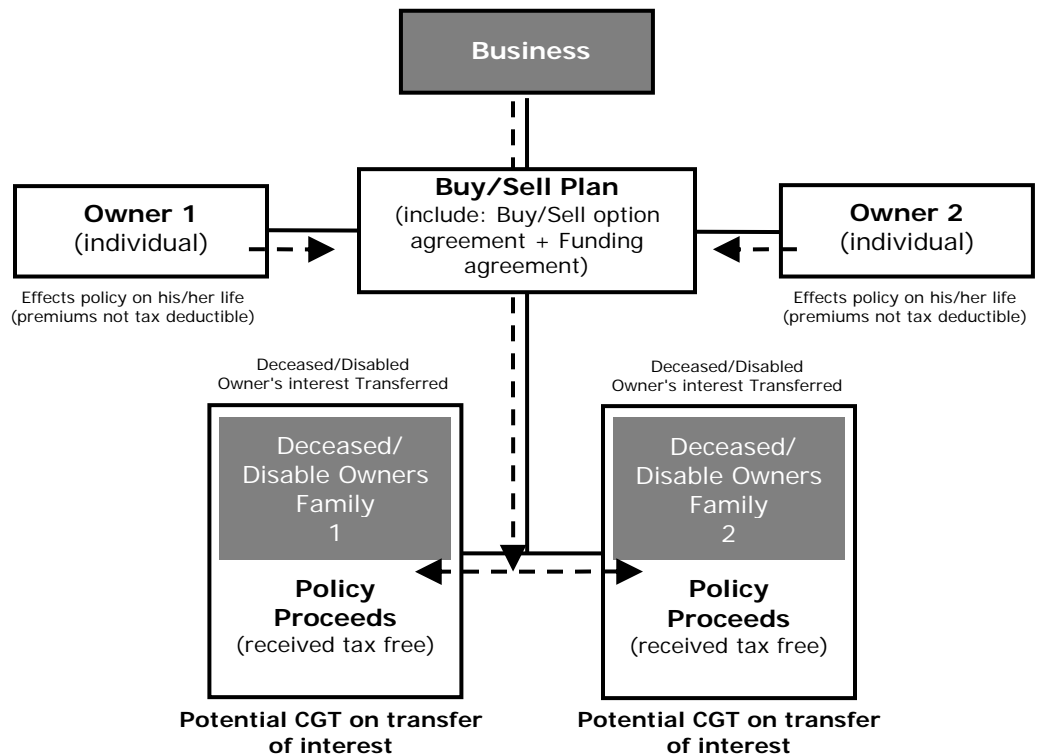
Insurance can play a significant part of the arrangement. In most cases the contract (Buy/Sell agreement) comes into effect on the payment of an insurance claim for death, total and permanent disablement or critical illness to one or more of the partners. This then triggers the transfer of their share to the surviving partner(s).

When structuring insurance policies for use in buy/sell agreement there are many arrangements and policy ownership options to plan for the efficient and orderly transfer of ownership of a business on the death or disability of one of the equity parties or controllers.

The ownership of any insurance policy is also dependant on the structure in which the business operates from. Policies can be held by:

- Self insurance
- Cross owned insurance
- Trust owned insurance (Discretionary trusts)
- Trust owned insurance (Bare trusts)
- Owned by superannuation fund

The diagram below is an example of how a Buy/Sell agreement is structured using insurance as funding:



## Tax Consequences

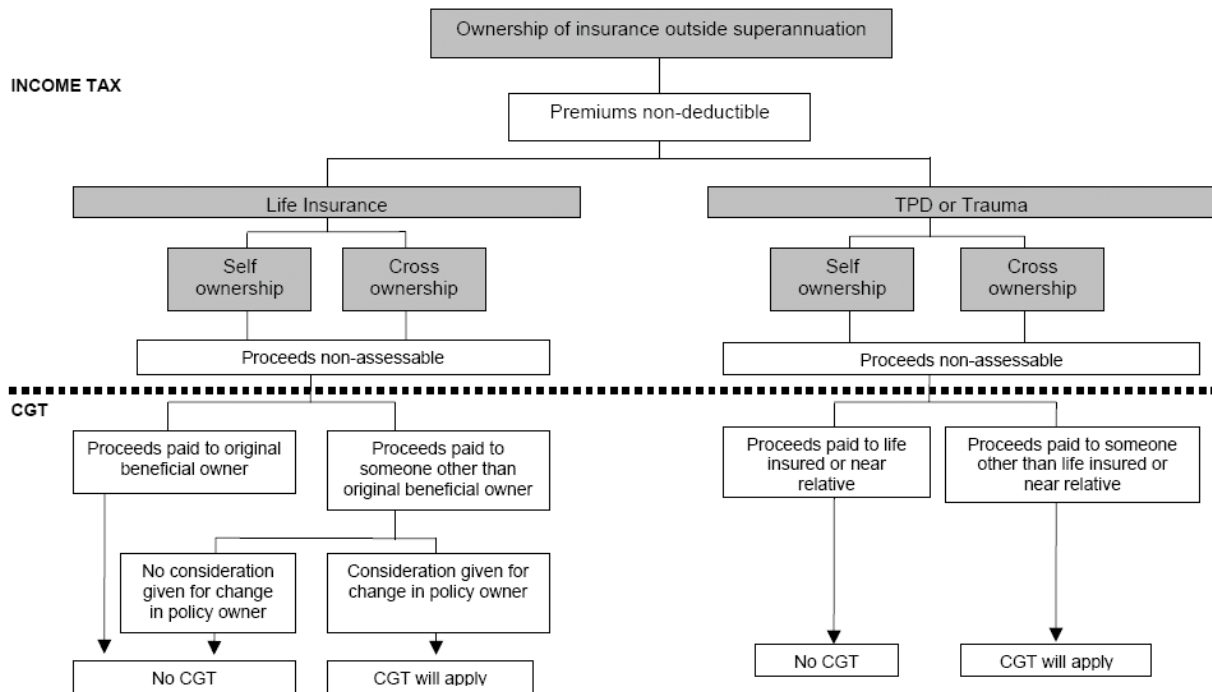
The end result of any buy/sell arrangement is that the departing owner (or their estate) will dispose of their business interest. This disposal will invariably create a CGT liability if that business interest was acquired on or after 20 September 1985.

In addition to the general 50% CGT concession available there are four small business CGT concessions that exist:

1. The 15 Year Exemption
2. The 50% Reduction
3. The Retirement Concession
4. The Roll-over

While the small business CGT concessions and/or the general 50% CGT discount may be available to the business owner or their estate, if the departing owner wishes to receive the gross (pre-CGT) value of the business interest, they might consider increasing the level of insurance to also cover the CGT liability.

The diagram below illustrates the tax consequences of insurance premiums used in a Buy/Sell Agreement.



## Issues to Consider

It is important to remember that it is largely up to the proprietors to determine how they wish to structure the agreement and what issues they wish to deal with.

In considering these issues, the parties should consider both the short and long-term, the nature and structure of the business, and the circumstances of each proprietor (eg, in relation to an individual: their age, marital status, and the existence of children who may later come into the business).

There are many other issues to consider but it is beyond the scope of this paper.

## Who can Help?

*"We believe an educated client is a good client."  
Sonny De Silva*

For more information or an in-depth discussion on succession planning strategies or any of the points discussed above please call De Silva Accounting on (03) 9706 0122.

With our depth of experience and focus on providing positive outcomes for clients, we would be pleased to help.