Succession planning for family businesses

For most family businesses as well as private groups, succession planning (sometimes known as transition planning) involves considerations around the eventual sale of your business, or the passing of control of it to other family members when you retire. Depending on your circumstances, this may include realising assets and making other changes to ownership, but is certainly tied up with retirement planning and estate planning.

Adopting a sound tax governance framework can help you manage tax issues around succession planning before they present a problem. Though succession planning may not have an immediate tax impact, it's important to include tax considerations in your plan. This will avoid unexpected tax issues arising down the track when you implement your plan.

Transferring control of your business to family members may involve restructuring your business operations – changes to share structure, changes to the trustee and appointor of a trust, changes to partnership structures – or transferring assets to family members via the creation of trusts or other entities. Remember that these sorts of events can have legal and tax implications that need to be carefully considered. A common assumption with business owners is that the transaction being considered is a single "sale" — that of the business — whereas it is actually many sales of individual assets that need to be accounted for, possibly with different tax outcomes.

For example, when you dispose of or transfer your business assets there will likely be capital gains tax (CGT) consequences. The sale of a business can also trigger liabilities in relation to GST and, where applicable, wine equalisation tax, fuel tax credits and excise duty.

Where pre-CGT assets are involved, you should also understand and document the tax consequences for you and your beneficiaries. Issues for consideration include whether changes in the business operations may affect the pre-CGT status of the assets or shares and the availability of carried-forward losses.

Any significant changes to your business structures or operations (including any asset disposals) should be fully documented, along with their tax impact. Ensure information on your assets (such as acquisition dates and cost base) is properly documented. This will also ensure that any subsequent disposals of the assets can be treated correctly for tax purposes. Different strategies will have different tax consequences for the owner and beneficiaries.

continued overleaf

Succession planning cont

Consider each strategy and identify (and keep records of) significant transactions.

For example, say, as the owner of a successful family business, you prepared a basic succession plan many years ago, but since then your business has expanded and your children have grown up. One of them may work with you in the business and you would like to see them take over when you retire. The discussion you could have with this office would be how best to transfer the business and make the transition to retirement.

One option could be to restructure your business as a family trust, so you can still have some control of the business while reducing your involvement in the day-to-day operations. We can explain the tax consequences of this strategy, while also alerting you to other options and tax considerations. Once you decide on your strategy, you update your succession plan, which now includes a section detailing the tax treatment and tax payable on transfer.

Whatever strategies you use to transfer your business onto the next generation, make sure your plans are documented and you seek advice from professional advisers where needed. This will reduce the risk of incorrect tax treatment and outcomes, and possibly consequent penalties.

Rental properties cont

Cash jobs

It's not unheard of for the tradesperson offering the best quote for a repair or maintenance job on your rental property to ask for payment in cash. Before rushing in to accept such a quote, just make sure they're not keeping the job completely off the books and that you'll still be getting an invoice that satisfies the substantiation rules. Otherwise you could end up blowing your cost savings (and maybe more) because you won't be entitled to a tax deduction for the cash you've handed over.

What your tradie does in relation to his tax affairs is a matter between them and the Commissioner, but it shouldn't cost you a tax deduction. Always insist on getting an invoice.

Holiday homes

Own a holiday home? Great for family holidays, but if the property is also offered for short-term rentals there are a few wrinkles you need to be aware of.

The main one is that the property needs to be genuinely available for rent, and not just at times when demand is seasonally low. So if you book the place out for yourself or family and friends for all or most of the school holidays and other peak times, the ATO will take the view that you're not seriously trying to make a profit from any rental income you receive and will limit your deductions for mortgage interest, rates and land taxes, repairs and maintenance, insurance etc to the amount of your rental income. Likewise if you only charge mates' rates when family and friends come to stay.

Some holiday house owners have even pretended to market their property by demanding excessive rents or imposing unrealistic conditions for short-term stays (eg, references, no pets, no kids). That is not likely to pass muster either.

Some limited personal use of the property is acceptable to the ATO, as long as you're genuinely trying to turn a profit. Where this is the case, the deductions claimed need to be pro-rated to reflect the time the property was let or was genuinely available for rent.

Any disallowed deductions won't be wasted entirely as they will create a capital loss on the sale of the property.

Please contact us if any of these issues raise concerns for you.