

BUSINESS OWNERS: THEIR SMSF AND RELATED SUCCESSION ISSUES

Jon de Fries, Senior Consultant – Succession Advice, MLC Advice

#NC2020




Jon de Fries
Senior Consultant – Succession Advice, MLC Advice



As Senior Consultant, Succession Advice, Jon specialises in advice support in areas such as estate and business succession, business structures, superannuation and tax.

Jon has worked in various roles in the industry for over 25 years, including managing the technical teams at MLC, ANZ and AM Corporation. He regularly conducts workshops for advisers and speaks at industry conventions.

Jon has a Bachelor of Economics (University of Sydney) and Diplomas in Financial Planning and Superannuation Management.



Disclaimer

This presentation is for general information only. Every effort has been made to ensure that it is accurate, however it is not intended to be a complete description of the matters described. The presentation has been prepared without taking into account any personal objectives, financial situation or needs. It does not contain and is not to be taken as containing any securities advice or securities recommendation. Furthermore, it is not intended that it be relied on by recipients for the purpose of making investment decisions and is not a replacement of the requirement for individual research or professional advice. Actions, reactions and interpretations cannot be relied upon.

The presentation is purely the opinion of the presenter on the day and this presentation is record of that opinion.

This presentation was accompanied by an oral presentation, and is not a complete record of the discussion held.

No part of this presentation should be used elsewhere without prior consent from the author.

© 2020 SMSF Association Ltd

#NC2020

What the business succession opportunity looks like



Businesses in Australia

- 2.1m businesses of which 2/3rds family
- Estimated \$3.5 trillion transfer of wealth and 80% of family business owners looking to exit in the 20s

How do owners envisage their exit?¹

- 44% plan to sell their business now or later
- 64% would seriously consider selling it if approached
- 21% plan to pass business on to the next generation
- Only 10% of SMEs have a documented succession plan/ buy-sell agreement²
- Only 6% have key person insurance³

¹ The MGI Australian Family and Private Business Survey 2013
² Cameron Research Group 2008
³ DBM Business Financial Services Monitor 2014

Case Study – Therese Rein



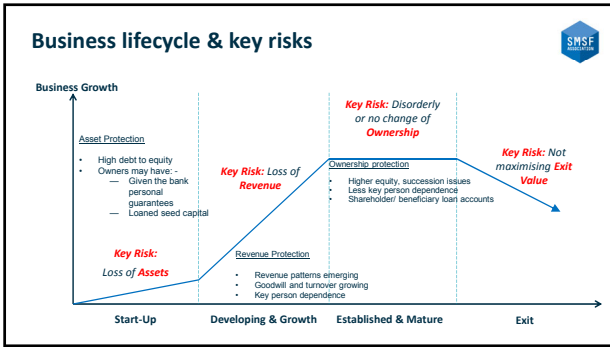
- Started Work Directions in 1989 with business partner Frances Edwards; it began by assisting injured workers find work
- Insurance-funded Buy Sell deed valued the business at \$1,050,000, but Edwards uninsurable
- Deed with fixed \$ valuation not reviewed
- Edwards died in 2006, the business now global and diversified and re-branded to Ingeus
- Executors of her estate tried to block sale of 5,200 shares to Rein for \$525,000 (< 10% of value)
- Rein won in the Courts and took full control of business worth \$10.5 million
- 2012: she sold US based Providence Service Corp, the following year on BRW Rich List @ \$210 million

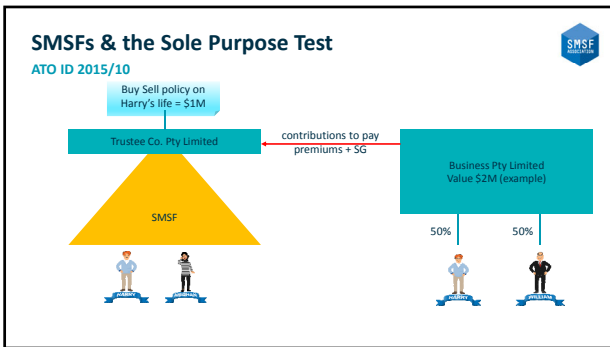


Major concerns of business owners



- Ending up in business with their business partner's spouse if anything were to happen to their business partner
- Personal assets such as the family home at risk for business debt
- Extracting full value from the business: investment of money, time and intellectual capital
- One child in the business and another out
- Business passed to next generation and income for retirement?
- What life will they have after they exit the business?





SMSFs & the Sole Purpose Test

ATO ID 2015/10

Sole Purpose Test

- Buy Sell Deed required:
 - trustee to purchase life policy based on agreed market value of Harry's interest in the business
 - company to make additional contributions to SMSF to pay the premiums

Trustee has provided financial assistance to William

- He's relieved of having to pay premiums for policy on Harry's life
- The policy proceeds enabled William to gain total ownership of company

However...

- It was an unusual buy sell deed; SMSF 'hardwired'
- ATO cautioned the breach was 'based on the facts of that case only'¹

¹SMSF Adviser 11 January 2016

Super & buy sell insurance

ATO ID 2015/10



- Represents a backflip over previous APRA and ATO advice
- Nothing from ATO in five years since ID
- Most 'super buy sell' done in retail super funds
 - Trustee is not a party to buy sell agreement
- Impediments to 'super buy sell' generally:
 - \$25,000 cap
 - lump sum tax on death benefits and TPD benefits

1SMSF Adviser 11 January 2016

Not all succession is clear cut...

Income Protection/TPD



- Income Protection funds a business partner who is ill or injured (but for how long?)
- APRA has indicated their intention to intervene in the retail IP market
 - no more Agreed Value from 1 April 2020, and
 - a cut back to 12 month lookback on claim from 1 July 2021
 - what about business owners and other clients whose income fluctuates?
 - **lock in IP policies prior to changes**
- Long term IP claims but not TPD (grey zone):
 - rules will tighten long term IP benefit periods
 - policies will not be guaranteed renewable

1SMSF Adviser 11 January 2016

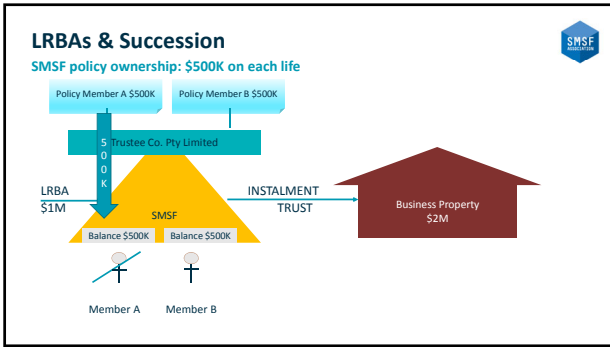
Case Study

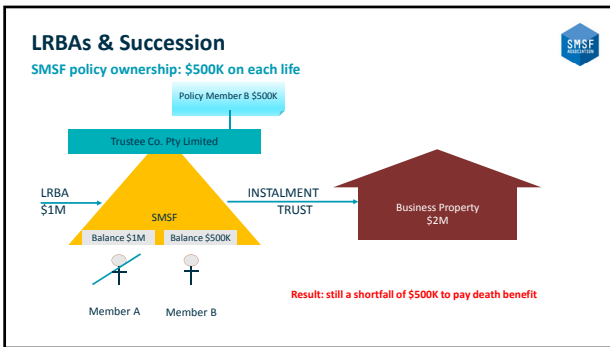
Harry and William operate a business, and their incomes fluctuate

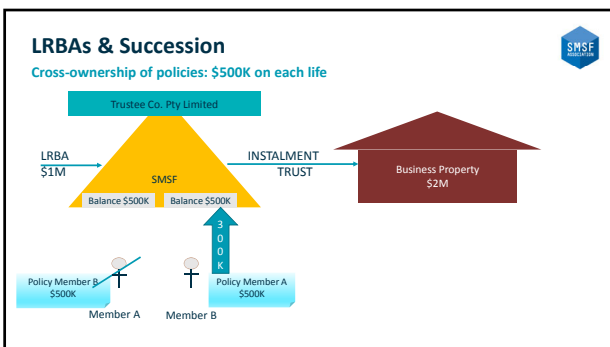


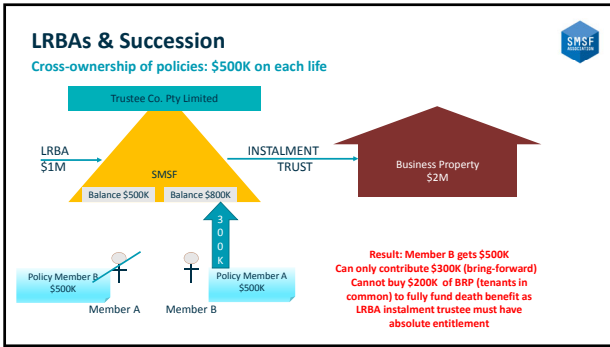
- Underwritten on an indemnity policy of \$220,000 in 2020/21 (monthly benefit 75% = \$13,750)
- Policy on claim will look back to highest 12 months income in three years if written by June 30 2021 or 12 months to claim if written later
 - including 'addbacks' for Meghan and Kate who draw \$37,000 each from the business, and
 - Harry falls ill: what is the outcome?

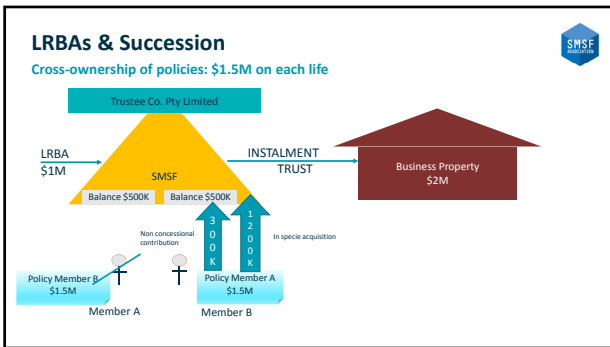
| FY earnings | Harry | William |
|--------------------------------|------------------------------------|-----------|
| Year 1 | \$250,000 | \$250,000 |
| Year 2 | \$220,000 | \$220,000 |
| Year 3 | \$120,000 | \$120,000 |
| Claim on pre July 2021 policy | \$13,750 (i.e. 75% x \$220,000)/12 | |
| Claim on post June 2021 policy | \$7,500 (i.e. 75% x \$120,000)/12 | |

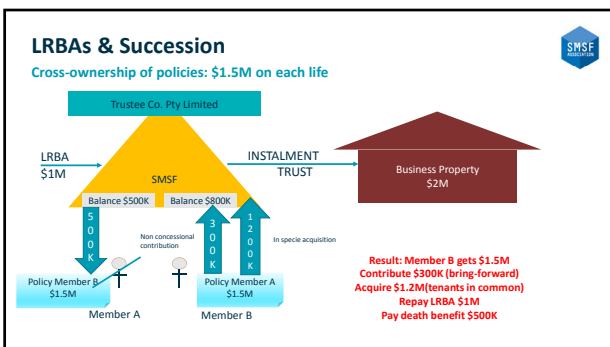












LRBAs & Succession



Issues

- Insure for life only (death compulsory is a cashing restriction)
- Pay a lump sum: pension to widow problematic
- CGT on cross-owned TPD if members A and B unrelated (s118-37 ITAA 97 exemption unavailable)
- Other solutions? Sale of business property

SMSFs & Business Debt



Issues

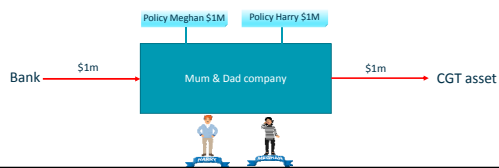
| Business owned policy | Self-owned policy | SMSF owned policy |
|--|---|---|
| Premiums non-deductible | Premiums deductible | Premiums deductible |
| No FBT | FBT | No FBT |
| CGT on TPD and trauma proceeds | No CGT on TPD and Trauma | No CGT on TPD, own occupation TPD and Trauma not possible |
| Less optimal outcomes on company wind-up | Debt subrogation & Commercial Debt Forgiveness unless Debt Agreement entered into, however... | |
| | On-lend strategy possible if business owners are partners or sole principal | On-lend strategy possible if business owners are partners or sole principal |

SMSFs & 'on-lend' strategy



Scenario 1 - traditional advice

- Mum & Dad business (company) has \$1M bank debt
- They have an SMSF
- Their company holds life policies for \$1M on each life to cover CGT asset acquired for \$1M

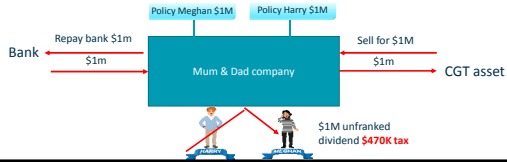


SMSFs & 'on-lend' strategy



Scenario 1 - traditional advice

- Mum & Dad business (company) has \$1M bank debt
- They have an SMSF
- Their company holds life policies for \$1M on each life to cover CGT asset acquired for \$1M



SMSFs & 'on-lend' strategy



Scenario 2 - strategic advice

