

Buy-Sell Agreements

A Buy-Sell Agreement ('BSA') governs a vital aspect of a business relationship. As a bare minimum, a BSA provides for the compulsory acquisition of a co-proprietor's equity in the business on their death or incapacity.

If there is no BSA, then on a proprietor's death their interest in the business is dealt with under their Will (or intestacy if there is no Will). This may result in the deceased's spouse and/or children owning equity in the business without having any involvement in running it.

This is generally not a very good outcome for the other business proprietors. A BSA prevents this happening as the other proprietors can buy the deceased's equity under a binding contract; namely, the BSA. They do not, therefore, have to continue to operate the business with the deceased's family.

Note that a BSA can provide for other 'triggering events' such as failing to achieve certain targets, insolvency and becoming disqualified from practice.

Failing to achieve minimum targets is normally critical to a person's contribution to a business. However, often these targets are not documented or binding on business proprietors. Personal and team targets can be included in a BSA (eg, revenue targets, billable hours, etc).

A BSA should also provide for voluntary transfers of a proprietor's interest. A BSA should specify such things as the notice period, valuation procedure, payment terms and when outsiders can acquire equity if the continuing proprietors do not wish to do so.

Insurance provides funding to acquire a departing proprietor's equity. Adequate insurance is generally vital to ensure a BSA will be commercially viable.

There are several methods of structuring insurance (eg, 'cross', 'self' and via a 'trust structure'). Each method has its advantages and disadvantages depending on the type of business structure (eg, company, trust or partnership).

Unless the insurance is properly implemented and the BSA is carefully drafted, the insurance

proceeds could be taxable. Thus, those preparing the BSA should have tax expertise.

Further, there are tax risks if a specified value for the business is stated in a BSA (rather than relying on 'market value'). Typically, the BSA is subject to a condition precedent to ensure there are no immediate CGT consequences. The condition precedent must relate to the formation of the contract as a whole (and not merely relate to a subsidiary part of the contract).

Substantial uncertainty, costs and delay can be avoided if an appropriately drafted BSA exists. DBA's BSA has alternative dispute resolution and detailed provisions on how a valuation process should be undertaken to minimise the potential for any uncertainty.

It is also important to regularly review a BSA.

SMSF Deed Issues

DBA regularly reviews SMSF deeds. We are aware of numerous deed suppliers who are still supplying deeds today that do not comply with the current law. Typical shortcomings of these deeds include:

- The deed does not allow a market linked pension to be paid despite the regulations for these pensions applying from 20 September 2004.
- A 'dependant' is defined to include only children who are under 18 years. Thus, on mum and dad's death, the adult children miss out entirely and the death benefit can be squandered by the minors on their 18th birthday.
- The deed does not allow an internal roll-over of a pension. Thus, the pension must be commuted and rolled-over to another fund.
- The deed does not allow contributions from persons aged under 65 who are not gainfully employed.
- The binding death benefit nomination provisions either do not work or are void for uncertainty.
- There is insufficient flexibility in order to undertake certain investments and planning strategies.

DBA provides a critical 20 point SMSF deed review service for \$220. A \$50 discount applies if a DBA deed of variation is ordered for that fund shortly after having a deed review undertaken.

Disclaiming under a Will

A gift under a Will may come with an onerous condition attached (eg, a gift of shares in a private company with a condition to pay off a debt). Thus, a beneficiary may want to disclaim their interest.

If a beneficiary disclaims a gift under a Will, the gift passes as if the gift had failed. The destination of the disclaimed gift depends on the type of gift and the terms of the Will.

If a non-residuary gift is disclaimed, the gift falls into the residuary estate (generally what is left after specific gifts are made and paying off the estate's debts and expenses).

However, if a residuary gift is disclaimed, the gift passes under the intestacy rules (as the Will no longer disposes of it); unless the gift is a class gift in which case it passes to the other members of the class.

Broadly, a beneficiary is taken to have no proprietary interest in an unadministered deceased estate. This is because no interest can be ascertained until the administration of the estate is complete, ie, when all property, debts, expenses, taxes and claims have been quantified and ascertained.

A vital issue that needs to be considered is whether a disclaimer gives rise to any taxation liabilities. The ATO considers that a renunciation by a mere object of a discretionary trust is unlikely to give rise to any CGT because the market value of the interest at the time of the renunciation is negligible. Thus, a disclaimer by a mere discretionary beneficiary should not give rise to a CGT liability.

Note, however, that the *Duties Act 2000* (Vic) was recently amended to ensure that stamp duty is payable on a disclaimed gift under a Will, codicil or intestacy to the extent it includes dutiable property. Duty is now payable even if the estate has not been fully administered. Previously, it was argued that no duty was payable on a disclaimed gift for the reasons discussed above.

Note that a CGT event occurs if there is an abandonment, surrender or forfeiture of an intangible asset: see s 104-25 ITAA 1997.

Pension & PDS Kits

In addition to having DBA advise on and document a pension for a client, we can provide Pension Kits to assist advisers and clients to document pensions. We also offer Product Disclosure Statements for pensions. These cover allocated, market-linked, lifetime and life expectancy pensions. Check www.dbabutler.com under Products and Pensions for further details.

Thus, careful consideration should be given to the tax consequences before disclaiming a gift. There may also be asset protection risks if a gift is disclaimed. Careful planning of each person's estate plan should overcome these risks.

Reverting a Pension

The decision of whether to make a pension reversionary is critical.

If a pension is made reversionary, the deductible (or tax-free) amount is likely to be reduced unless it is for a term certain (eg, market linked or life expectancy pension commenced after 19 September 2004). This is because the undeducted purchase price is divided by the longer of the primary or reversionary beneficiary's life expectancy to calculate the deductible amount.

The ATO has recently expressed the view that any change to a term or condition of a pension may result in a fresh pension being commenced.

Thus, if an allocated pension is commenced as a non-reversionary pension (say to obtain a greater tax-free amount) and on the death of the pensioner, the pension is reverted to the surviving spouse, then this may constitute a fresh pension (as a term of the pension has changed).

The ATO's view is expressed in SD2004/D1, which provides that a fund's rules are amended simply by a trustee making a resolution (even unwritten) specifying a term or condition of a pension.

In the above example, a fresh RBL assessment would apply to the surviving spouse.

While we do not necessarily agree with the ATO's view, care needs to be taken to ensure each pension is properly documented from the outset and on any subsequent changes, eg, on reversion.

For further information please contact:

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