The Deal Room Podcast

Episode 185 – Tax at Exit – tips, traps and the importance of proper planning

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Transcript

Joanna: Hi, it's Joanna Oakey here and welcome back to the deal room podcast, a podcast proudly brought to you by our commercial legal practice, Aspect Legal now today we have on the show Paula Tallon, who is a Tax Director at Prosperity Advisors Group. Paula and I are talking all about small business CGT concessions, ie tax, and how to save some tax at that

point have exited the business and why it is so important to have an understanding of these elements well before the point of sale and certainly a really good understanding also at the point of sale, even if you've not been able to get in that preparation beforehand in advance. So this is a two-part episode because there's so much that Paula and I really wanted to talk about in this area. The part one, which is this episode you're listening to right now we talk about the Small Business CGT concessions what they are, and mistakes that are made by business owners are sometimes right at the beginning of their business. And then in other times, making decisions along the way in relation to perhaps even properties that they're purchasing things that they're doing from a personal perspective, or other businesses that they're getting involved in. And in part two of our two-part series, we talk about some stories. We have some fabulous case studies that we review where we look at businesses prior to exit and we also look at businesses that exit and some things that business owners do that assist them and then that can create real problems for them from a tax perspective. So here we go with part one of our two-part series with Paula Tallon from Prosperity Advisors Group.

Joanna: Paula, thank you so much for coming on to The Deal Room podcast. I'm really excited to have you on the show today.

Paula: I'm excited to be here. And I'm looking forward to talking about small business and tax.

Joanna: I know when you say that, you say this, though not everyone might be excited to talk about small business and tax. And I know, it doesn't necessarily sound like the most exciting area. But when we're talking about the ability to save people, stacks of money, at the end of the day, on the amount, you know, the difference between the sale value and what they actually get in their pocket, you know, true to tax, I think it's safe to say we really do have the attention of a lot of people. And we should, because it's such an important topic, you know, and I just want to preface this by saying the reason that I really, really, really want to drive into this is that I see, so many business owners come to us where they haven't had deep advice in this area. And quite often, that's because they haven't even really understood that there can be a massive difference in tax outcome, depending on the way that a sale is approached, and depending on the preparation of the business leading into a sale. So I just think it's such an important topic. And I think we are doing our listening community a huge service here digging into this topic. I love this topic because I see every day the difference it makes in the wallets of our clients that exit. So I think it's critical.

Paula: Yeah, Joanna, I totally agree with you. Because for most businesses, the owners, build up these businesses, they tie up all their capital, and it can be the means of retirement. So they're relying on these concessions to save some tax when they sell. So the disappointment and the financial consequences of not falling into these concessions can be quite steep. And I suppose for a lot of businesses, they're completely unaware when they start out on that business journey that decisions they can take maybe at starting out the business as they grow the business as they go to that lifecycle. Those kinds of decisions can impact whether or not they get concessions when they eventually sell.

Joanna: Yeah, absolutely, absolutely. And just before we get into it, I'd also like to mention that we are about to run a webinar where we going to dive deep into this topic. And then as I've said, I'm not going to repeat it. But I just think it's such an important topic that we can't do it service in just talking about it in a couple of podcasts, we'll try to give it a bit of love in a couple of podcasts. But we were, if you're listening to this and you're interested in finding out more, then you'll find a registration link in the show notes to this podcast episode where you can sign up for our webinar and come along and ask questions.

And you know, get involved and understand how this can impact your business and the amount that you take home at the end of the day. But also, if you've missed the time of the webinar, and we do know people listen to our podcast years in advance. So if you've missed it, don't fear, we're going to have it available for you perpetually on an on-demand basis. So of course, if you make it live, you'll be able to ask questions and get some answers relevant to you. But if you've missed it, don't fear, it will be available on demand. So check out the show notes. Right. So moving back, let's start at the very beginning. As I say, Paula, that's a very good place to start.

Paula: Yes, Joanna, it is a great place to start. And I wish a lot of tax planning starts at the beginning. Unfortunately, sometimes we're at the end trying to get back to the beginning. Yeah, but as far as just, you know, if you're a business owner, why do you care about these concessions? Why does it matter? How does it reduce your tax bill? Because that's what you're interested in? Well, if we look, there are four different kinds of concessions, which potentially be available to you as the business owner. The first one is the 15 year one. So, you know, if you have had your business for 15 years you meet certain conditions, then what can happen is the capital gain that you make is completely disregarded. Now, sorry to use a tax term there but disregarded means you don't pay tax on that it completely is left out of your computations. Then you've got your other concessions, you've got your small business 50% reduction. So if you were to make, say a 4 million gain on the disposal of your business, that 50% reduction would take your gain down to 2 million that's quite valuable. And remember, you still have the other 50% discount You get for normal capital gains tax, so you could have that gain again.

So when you start looking at those kinds of numbers, it does become very valuable, then you've got your retirement exemption. So for somebody who's selling out and retiring, you get your lifetime limit. Unfortunately, that doesn't disregard your gain. It just gives you 500,000. But you know, those three business concessions I've just mentioned, are very valuable. They give you loads of relief. And then the fourth one you have is the rollover one. Now the rollover, one is more of a deferral, what it does, it allows you to take your money on your gain and say, Well, I'm maybe going to roll this into something else. And I have a few years a two year deferral period to decide, what am I going to do with that money. Now, if you're someone who's nearing the retirement age, it may be that you're 53 or 54. And if you were to roll that you might actually fall into one of the other concessions as well. So all of these concessions can work together. So it's not that you just get one of them. You could get one of them, two of them, three of them, it depends on what way it's going to go. But of course, if you fall into the first one, the 15, year one, your gain is disregarded, you don't care

about the rest. So I think, you know, that gives a flavour of why it's important to look at these reliefs at this stage.

Joanna: Yep, absolutely. Absolutely. I guess it's there are two aspects out there, there's these IU structured now with the end in mind. And then when you come to exit, are you adopting the right approach to the sale structure or the deal structure that will give you an optimal outcome? Now, what often happens is we'll often deal with businesses, the time has come to the end, they're at the point of exit, they're ready to go. So the needle that they can move at that point, the only needle they can move is the way that the sale is structured, but there is all so this other element of getting themselves prepared in advance. And of course, that's that is what we would be hoping for our entire client base, isn't it that they have thought about the subject well enough in advance that they know what it would look like for them and exit? And then they'd know what the deal structure would be ideally an exit as well?

Paula: Yeah, I totally agree, Joanna. And, you know, in looking at this consent, the CGT concessions, you can take advantage of them. If you own the business as a sole trader, you can take advantage of them if you have shares in a business. And it works in slightly different ways as regards the active assets and everything. And that's something we're going to cover off as part of our webinar because that's digging really deep into it. I think, you know, what we're looking at now is seeing what, you know, what are the basic things that people could be doing now to access these concessions at a later date? So what are their sort of sensible tax things they could be thinking about? Hmm,

Joanna: Yeah. Fabulous. Okay. All right. And so we've had a bit of an introduction into what the Small Business CGT concessions are what's generally available. Why, I guess, maybe if you can just give us a headline idea of some of the issues or the mistakes that you've seen made? I think that'd be interesting. Yeah, of course, in our webinar, we're going to drill into these in a lot more detail. But I think it'd be nice to touch on some of those things.

Paula: Yeah, definitely. And I think, you know, the starting point is to access any of these, then you have to have some kind of a CGT event. So you have to have disposal, whether it be a business of shares of trust that someone has to make a disposal of something related to the business. And then you come down to what's known as a sort of, I always call them the gateway. And it's always sorry, to digress. But if you think of these small business concessions as something, you need to take a wet towel, put it over your head, go into the darkroom, and work your way down through them. Because it is like working through a maze. And you know, you could get down one bit and it's like, oh, turn around, come back dead and fit down another bit. So you do have to work your way through all the provisions and everything. But the main gateway ones you're thinking about talking about today is you've got either you're a small business entity yourself, so you're within the 2 million turnover limits. Or if you haven't got that, then you meet the net asset value test. And that's that your net asset value is not greater than 6 million. And I suppose if we look at what is your net asset value, and that's where it can get quite complicated for people because it's well, which assets Do you include? Do you include all your assets? Do you include the assets of your spouse? Do you include the assets of your partners who you may be in partnership with how

far does that going, including assets? And also, if you're looking at those assets, well, how do you value those assets. So we talked about asset valuation. So we're looking at the market value of those assets. Now for some assets, it's easy to what the market value is. But if you've got shares in private companies will, you know, at the end of the day, the value of those is what someone else is willing to pay for it. And you can ask three valuers to put a value on a private company, they'll all come back with something different, and none of them will be wrong, because a lot of it is a subjective view, taking into account certain parameters that they all workaround. But until somebody actually put some money on the table to buy that business, you don't really know what the true market value is. So if the object of the CGT sale is the sale in the short sale of shares, well, at least then you'd have a rough idea, you know what that market value is because somebody has put an offer on the table. But if you hold other private shares, then an evaluation exercise would have to be carried out on that. You also look at things in such as any other assets that you might have, you might have investment properties, you would have to include those, you would have to include any assets that are not personal use assets. So any answer to you might derive income from, you'd include your bank account, the cash you have in the bank, you don't include things like superannuation, you don't include your life insurance. And then once you've looked at all of your assets, and you've added those up, then you take off any liabilities that are associated with those assets. So for instance, I suppose very simplistic, really, if you had a property and you had a loan against the property, they would net off, it can get more complicated for people use general overdrafts because it's not clear what that overdraft is actually funding when you get down to start looking at the net asset value of an entity itself, it can get very complicated because you have to go through what all the liabilities are within the entity and whether or not they contribute to the assets, which are being included in the net asset test. And then once you've looked at yourself, then you've got to start looking at your affiliates.

Joanna: So I just want to stop you there. Because I think that this affiliate side is one of the areas I say one of the areas, I think there are many areas that are misunderstood, yes, but I think this affiliate area is one of the misunderstood areas, because of course, if you if you're a business owner who has your finger in a few different pies in a few different businesses, this can be the element that could be tripping you up. So maybe if you can dig into this yet.

Paula: Let's take the simplest level, let's take a husband and wife. Husband has a business wife has a business on the face of it, they are affiliates, but they would only be included as their business assets would only be included as part of that net asset value calculation, if they were able to have control over that other entity, if they were able to influence decisions, perhaps if there was substantial commercial interdependence between those entities as well. So if there was a lot of trading between them, or maybe if they just propped up against each other's businesses, bypassing business to each other, that could bring them in together. And I suppose you know, if you think of something quite simple, if two spouses, they each have a business, and they sit on the boards of each of those businesses, that could actually bring those other businesses into their net asset value, and there may not be contributing loads to those businesses. So maybe be better for them not to be on the boards of those businesses, may be best for them not to be involved. Because I suppose if you think when someone starts out in business, the first thing everyone thinks of is, oh, everyone should be involved. If

they can, within the business, everyone should have chips in the business, they should have an influence in the business, and then we can get some income to everyone as well. And yes, that works now. But what happens when that business grows, and then other family members have other businesses and then all those values start coming in now, you know, they don't automatically come in, you have to be able to show that there is that dependence between them, or it might be those control. So if you've got an interest in another company or something, it's whether or not you control that company. So if you've got more than 50%, then you have got control of that company. So the assets, the net assets of that company would commit to your net asset value calculation. If you've got say, between 40 and 50, then control is assumed unless you can prove otherwise. So then it's trying to prove while you don't bring those assets in those business assets in and if you've got less than 40%, then you don't you're not taken to have control. That company could still come in and under the affiliate rules. And then if you're looking at controlled companies and affiliates that you can bring in your affiliates controlled and connected companies. So if you think of it almost like a crack in a window, you know, you start off with this crack, and then it all starts to creep outwards. And it's making sure that it doesn't creep too far, and that you haven't got all these assets coming in.

Joanna: And, you know, I guess that's part of the planning process, then that maybe is forgotten. And I just want to summarize it, because there's a lot of information here and it can be really overwhelming. So just in summary, we're talking about what are the qualifiers to give us access to the Small Business CGT concessions, the Small Business CGT concessions give us the ability to whittle down the base upon which, you know, tax is calculated, or, you know, reduce the tax payable based on whether or not we qualify on this either $2 million turnovers for the business that we're talking about. Or if it's high than 2 million in revenue, then we're looking at a net asset value of 6 million. So this is where when we looking at the net asset value, we're looking at the windscreen crack. I love your analogy there, Paula, we've got these windscreen cracks going on. Because we're saying that there can be a whole heap of things pulled into this calculation of the net asset value that are we looking to keep under the 6 million so that we can access these concessions that mean we pay less tax, right? Have I summarized it correctly?

Paula: Very good summary.

Joanna: And it's Look, it's confusing for everyone because there's a, you know, there's a lot of layers, of course, we're on a podcast, you know, our poor listeners might even just be walking along the beach looking out at the sea thinking, my goodness, I didn't realize this was going to be so complex. But the point is, you don't have to fully understand this, you need to understand when to pull in people to help you understand what the future looks like, and what future exits could look like. So yeah, you don't need to feel too overwhelmed.

Paula: Yeah, I think you're right, but it is having sort of those flags from the outset. Yeah. Because I don't know whether you've ever had in life sometimes where you turn around goes, Well, if someone had mentioned that, to me five years ago, that would have been on my radar. Yeah. And it can seem strange having a conversation with someone about a

possible exit of their business if they're really starting out. But actually, that's the time to have those discussions. And, you know, I say, I've had my own business. And I remember, at the very outset, I was thinking, what would happen when I exit that business? Have I got the right structure and games? And that's why I know what's really important to people, because, you know, if you've got your eye on that end game, and perhaps that's your retirement part, that's how you're going to fund everything, then you want to make sure you fall within these reliefs. Now, if you're selling your business for more than 6 million, then, of course, you won't fall in there. But you're making 6 million on your business. So I think what we're trying to help is the people who are falling, maybe that there's hitting net asset values of 6.3, and 6.4. And maybe their spouse could have had one of the investment properties years ago, it could have been in their name, and they never would have been in that position. Or, you know, it may be someone selling their shares in the business and the sale of the shares because of the market value puts them up to 6.1. So if they had just taken 100, and something off their sales price, they might have had a disregard a capital gain. So it's I suppose it's having an eye on those negotiations as well.

I know it seems counterintuitive to say reduce the sale price, but it's the difference between a taxable gain and a disregarded gain. Yeah, you know that. I think that works. Yeah. And it's getting the kind of planning done from the outside. So you haven't got the business owner, basically squirrelling up all the funds on the assets themselves outside the business, because that they will tip them over that 6 million. So I suppose if you have a spouse who hasn't got a lot of assets, well, if you're investing in properties and everything, it's making sure that those investments are sitting with the right person, should this event arise that you're going to exit and, you know, we just need to be careful for if they sit in partnership with that person because that will probably bring the assets back in and under the affiliate rules. So it's all those kinds of discussions outside of the business that can have an impact on the business. And if you are coming up close to a sale, and there are you know, you think you might tip that 6 million or what kind of things could you do, and you could contribute some money into superannuation, that that could work.

You could fund a big holiday for yourself and your family and pay for it in advance. depends on where you go and how much space to really popular things people do. Is that They do some home improvements, a lot of home improvements that may not increase the value of the house. But if it's the main residence anyway, it wouldn't be coming in. So I suppose if you're a business owner with a lot of cash, and you're thinking and writing your property before you sell your business and pay your builders,

Joanna: Who would have thought many of our listeners just would not have thought the timing of their home reno pre or post sale could be so important. I think we are shining a light on some interesting areas here.

Paula: Yeah, well, you know, tax is always exciting. And when you get down into the details of tax, there are always loads of things you can talk about. And it is, I think, people think about tax sometimes, like, it's some theoretical thing, that they just pay a number, but actually, tax crosses everyday life, and it impacts on our lives every day. So yeah, you know,

it's understanding it and making people comfortable with looking at these kinds of tax decisions on a very regular basis. And if you've got entities that are growing, and they're possible will sell, restructure, or, you know, even sell to next generation, then these kinds of reviews of their position, if they were to sell now should be carried out on a yearly basis. So they're always looking at what, you know, if a buyer walked through the door today, would I be okay to sell? Yeah, would I have my concessions? Am I set up right to do that? And I think I think that's quite important, just having a look at that on a regular basis. But you know, sometimes some of these kinds of reviews and everything is left to the sales, current sale contracts on the table New Year. So let's talk about what's the tax position.

Joanna: That's so true. That's so true. I mean, even more so is when a business owner sells, you know, and, and post-completion, they take everything to their accountant, and then work it out. And that's just that's the worst outcome. I have so many discussions with business owners coming in who say, you know, what, one of the very first things I say is, do you understand what your tax position is? And how much you'll get in your pocket at the end of the day? And almost always, the real answer will start with a yeah-yeah-yeah. And then whenever yeah-yeah-yeah, I know, it's a no, actually not formally. And then when they dig into it further, it just is, you know, quite often, it's because the sale has been structured in a particular way. And I'll just wonder whether or not they actually understand. And you know, we don't get involved, of course, you guys are the accountants the problem when people haven't taken their accountants along with them on the ride, and then gotten the right advice from their accountants as well, because it's a tricky area, you know, and I guess not every accountant deals every day with the business at exit trying to deal with these issues of tax that exit.

Paula: Yeah, totally great. Although every candidate might deal with this, and the client might think they're dealing with Yes, yeah. And from the advisors perspective, you know, it does put them at risk, if they haven't looked at some of these issues, or perhaps haven't alerted their clients to some of these issues. And selling a business is such an emotional time for people as well because they've built something up. And you know, they really have their heart in the business. And it's very hard to watch a business owner sell their business and not get the right tax outcome. When you know how much they've sacrificed to get the business to the level they got it to, they've employed people, they've built something really good. So when you think they should be able to access these concessions, and then they don't, I actually feel quite emotional for them. Because that's what these concessions are there for. They're there for the people who build up businesses, employ other people and boost the economy. So you need to make sure they're getting them.

Joanna: Yeah, yeah, absolutely. I absolutely agree with you, Paula. And I think it's just such, it's so important. And but it's so important to look at, to look at early, but also to review. Because you know, if you're making decisions during the period of growth of the business, that might relate to you starting new entities entering into, you know, setting up businesses with others, sometimes the decisions that you're making there might have an impact as well on your net asset value. So it's important at least that you're doing that with the foresight of

that understanding of what the ultimate impact of all of that will be. So it's not a right at the beginning and then set and forget, it's about a journey of review.

Paula: It's definitely ongoing and you know, that just blows a thought in my mind about people's homes. has a case typically, if it's a holiday home that you use for yourself and your family, then that doesn't get included in net asset value. But if you allow other people to do it, when you charge rent, if you've done that on a fairly regular basis, then that asset could come into your net asset value. Now, some people who have holiday homes like that, because they're using it predominantly for themselves, and just letting a few friends use it for rent, they're not actually making much money on it. But because they have charged those people rent, then that asset is brought into that net asset value. So had they known that it would have been better not to let those people use it or something, they could have been better off. So there's all those kinds of little things outside of the actual business, that personal lives that need to be brought into this equation as well.

Joanna: Fabulous. Okay, look, I absolutely love it. We're going to be back next week with part two of this two-part discussion. And next week, we're going to be talking or maybe not next week, if you're listening to these straight in succession. In the next episode, you'll hear us come back with talking about some case studies because I really like stories. Paula, I've got a few to share. And I feel like you have got some fabulous, wonderful as well. But before we go, Paula, I just want to make sure we let our viewers know how they can contact you at Prosperity if they want to take the first step of ensuring that they have had a proper review from a tax perspective of what their exit might look like. How do people get in contact with you, Paula?

Paula: Well they can email me on PTallon@prosperity.com.au. And you can always ask me to call you back. I love a good text conversation. I'll be delighted to talk to you.

Joanna: That's fabulous. And we will of course as always link through to that in our show notes. So you can contact Paula directly. And stay tuned. Make sure you come back for Episode 2. Thanks for tuning in. And we will see you in the next episode. Paula

Paula: Thank you

Joanna: Well, that's it for part one of our two-part series, all about saving tax at the point of sale of your business and decisions that are made in relation to small business, that all that can impact small business CGT concessions. So this was part one of a two-part series. We're coming back in our next episode with part two of our two-part series, where we looking at the stories of some of our clients, Paula and I exchanged some more stories along the way, and also some stories where things have gone really well for our clients as well. So don't forget to tune in to part two of this two-part series. And finally, we have a webinar coming up that drills into a lot more detail in the issues that we're talking about today all about the expensive mistakes when selling your business. Now, Paula, we'll be talking more about the tax side. And I'll be talking from a legal perspective about many expensive mistakes that business owners can make when selling their business. So if you're interested

in coming along to that webinar, please make sure you check out the link in your show notes to register for that webinar. If you can't make it to a live event, we do have an on-demand version that will be running into the future after the event. But of course, if you can make it live, then you'll be able to ask questions along the way and you'll be able to get those questions answered.

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