The Deal Room Podcast

Episode 186 – Tax at Exit – tips, traps and the importance of proper planning part 2

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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 part two of our two-part series all about the expensive mistakes from a tax perspective. But when selling a business in part one of this two-part series, we looked at the Small Business

CGT concessions what they are, why you'd want to access them and some mistakes that can be made in trying to access them. In this episode, part two of our two-part series, we are drilling into some case studies some of those examples that Paula and I have dealt with in the past that are ripe for discussion in relation to this topic. Now just to give you a little bit of a background of Paula before we launch into the second part of a two-part series. Paula Tallon is the Director of Taxation of Prosperity Advisers Group with over 25 years of experience in the tax profession across larger mid-tier accounting firms in the UK and of course here in Australia. So Paula brings with us some fabulous experience in tax-efficient structuring successions and exits and she really understands the pain of business owners in trying to understand this really tricky area. So without further ado, let's launch into this episode with Paula. Before we do that, I just want to remind you that we have a webinar coming up very soon where Paula and I talk about the expensive mistakes to avoid when selling your business. Paula will be talking more about the tax perspective and I will be drilling into some really important legal areas as well. You'll find out how to register for that webinar in your show notes and also over at our website at www.thedealroompodcast.com. Look for this episode and you'll find a link there on that episode page. But for now, let's tune in to part two of this two-part series. Here we go.

Joanna: Today we're back with part two of our two-part series all about that exciting topic of tax. Wonderful. And we have the fabulous Paula here on the show to join us today. Again, Paula, thank you for coming back.

Paula: Thank you, Joanna. Delighted to be brought back.

Joanna: We had so much fun talking tax the first time around. And but I really want to talk stories. I love to hear the case studies. I love to hear, how does this play out in reality? And I've got a few to share myself. But why don't you kick it off by telling us what your most memorable stories of I guess issues or perhaps even you might want to talk about resolutions of dealing with small business CGT concessions and the qualification for business owners into those.

Paula: Yeah. Can I tell you my success stories first?

Joanna: Yes of course. I love success stories.

Paula: These are the people who keep you by their side as they grow their businesses. Because with those people, I can keep them in a way where you know, they can access the CGT concessions. Now in the last episode, we talked about that net asset value and keeping it at 6 million. And I suppose if I'm involved at a very early stage, I can help the family in those structuring so that let's say the wife has a very successful business, which she's going to sell. But if she also has all the other assets and the investment assets that the family have, then she will breach that net asset value if she goes over 6 million. Whereas had she come to me for them from the outset and had the conversations we would have talked about who owns those investment assets? Who should own those investment assets? How should it be structured? And other people in the family? You know, should she be involved in their businesses, or should she just step back. So with those kinds of cases, we can plan as we go.

And they're really good. The difficult cases. And I think I alluded to this in our last episode, as someone who turns up and they have a holiday home, and in their mind, their holiday home is not included in that net asset value. Now, if it has been used solely for them for their personal use and enjoyment, then it won't be included. But if they have allowed other people to stay there, and they have charged rent and perhaps claim some kind of an interest deduction or something, then that asset would come into their net asset value. And it means that you know, for the sake of what might have been a small amount of rent, they might have jeopardized their access to these small business concessions. But it's also making sure that the right people in the family are holding the assets, as I said, you know, making sure that the investments and all the businesses aren't held by the same person. So it's trying to spread that wealth around in the business.

Joanna: So not having the same person in the family hold everything. What other stories have you seen along the way? Because in the last episode, we're talking about some of those decisions, perhaps that might be made when a business owner is getting involved with other businesses. So you know, it might be that they're looking at holding a portion of the equity in another business. And we talked about the difference between a holding have greater than 50% versus a 40 to 50% holding versus a less than 40% holding. What what are some, I mean, have you seen examples along the way of people who maybe had taken the 50%. And they didn't realize that there could be such a massive difference how they felt 30% or 40% or done something else differently along the way,

Paula: I've definitely seen those kinds of cases where somebody thought of themselves as an angel investor in a company. And now if you're investing into a company, and you're putting substantial funds in, you normally do want 50%, because you're looking for that control aspect. But I had an individual who had invested into a company invested 50% in someone else's company. But he didn't actually take any real role in that company. He wasn't heavily involved in the company, there wasn't a huge amount of transactions between the company or anything, but because he took about 50% stake, then some of those assets then were brought into his net asset value calculation. And you know, it may have been that it could have been structured in a different way. He could have had, say 30 40%, maybe some loans into the company, we could have looked at a way where it wouldn't have impacted on his net asset value calculations. There is also the situation of I had an individual who was selling a business and they had a substantial bank balance. They'd been saving this money for years. And they had it all held in their own name. their spouse had hardly anything. So you know, by this individual holding all their family cash in their name that was bought into the net.

They put them up over the 6 million You know, it is difficult for families. And it depends on the type of family it is. I've dealt with a lot of Irish families in my time where, you know, one person is holding all the assets, because that's just the way it's done. Yeah. And you have a lot of grown-up children in the business, and they just have no assets in their own right. And the idea is, all of these will pass on death. And that's not necessarily the best kind of planning. Or you have families where the eldest brother holds everything, but everyone is supposed to have an interest, but nothing is documented.

Joanna: Yeah, right. Yeah.

Paula: They're my hardest situations, the ones where they're not documented. So you know, we could be talking to someone and going through and go, Oh, you've got an investment property, it's worth 3 million. And he goes over that for me and my brothers. But you've got it, and you've always declared the rental income on it. And he goes, "Yeah, but we all know, it's for me and my brothers". So according to the documents, you own the property, you've declared the rental income, you've paid the tax on the rental income? And then you get the answer. Well, I gave them their share of the money. And, you know, this kind of informal arrangements, while they might work fine for a couple of years, they do throw up this kind of problems at a later date. And it's not just for these concessions, it's problems on a much wider scale.

This is where I suppose for advisors to be close to their clients and understand what's happening. And yeah, not to assume that somebody necessarily owns the asset just because they tell you they do. Yeah, I'm one of these people. You know, somebody tells me something. When I'm doing tax planning advice, I always check their facts. Because what they want to be true, or what they believe to be true, might not necessarily be what the paperwork say? you know, or it might just have been the way things were done in the family for a long time. I've come across cases where somebody thought they'd inherited property, and they had never inherited the property. They say their grandparents had told them they'd inherited, but actually, their parents have inherited it. So there are all kinds of situations I suppose about what I like doing is getting to the bottom of those kinds of problems where people and it's a bit like, you know, if you ever tangled your jewellery, and you've put it untangle all these chains. Sometimes it is a bit like untangling all these things and laying them out. So you've got everything laid out. And you can see who has what.

Joanna: Yeah, well, I feel I do feel sometimes I roll from a legal perspective is a little bit like a detective as well, you know, as we're sort of like peeling back the layers and trying to get to the truth or the truth that we're able to substantiate with documentation. And you know, as well, because, you know, the truth from our client's point of view, quite often will have to be proven. So, I want to throw in some examples as well, because there are some things that I see a repeat, quite regularly. And one of the things that I see repeat quite regularly is a lack of understanding about the difference in the in accessing concessions or, or the value of concessions that are able to be accessed.

When we looking at shareholders of a company who were looking to sell their business, and they there, they usually have looked at a business sale without considering the difference between selling the shares, rather than selling the business out of the shares. And in some situations, it might be that they suddenly understand the tax differences very late in the transaction. And that can be a real problem, because it can be very difficult to change the approach of a buyer, in terms of visualizing a transaction from the perspective of buying a business, without the liabilities and the skeletons in the cupboard is as always quoted of a company. But if you know this early enough, there are actually some really great reasons for buyers to want to buy shares, rather than the business themselves.

And indeed, the larger the transaction value, the more likely it is that a buyer will want to undertake the acquisition by way of share sale rather than business sale anyway, because of some great benefits that we can have in relation to the transition of the business and, and retention of some of those and lowering the risk of leakage of some of those assets that they are looking to purchase. But let's looking at it from a tax perspective. And sorry, I guess my point in all of that is if we're getting early enough, there's a really good story to tell, to help get buyers engaged in the way that works for a seller from a tax perspective, but there's a problem If the seller doesn't appreciate the tax perspective until too late in the transaction, can you talk to us a little bit about what these differences and what the difference can mean? Because I have literally seen it mean, millions of dollars of difference, you know, in cash retained by the seller, as opposed to tax paid. So maybe talk us through your thoughts or maybe any stories as well,

Paula: Yeah, I suppose it starting off, we look at the concessions that concessions can apply whether you sell shares, or whether you sell a business out of a company. And it does come down to the active assets and everything else that we're going to be covering at the webinar. But I think what happens is a lot of probably advisors panic because they haven't been on top of whether or not the business structure is fit for purpose, whether or not it will actually get those concessions. So then they look at, well, actually, maybe we'll just sell the assets out because we know this is a small business entity, we know we're going to get the relief, and then we know we're okay. And I agree with you, it is very hard to change, change tack at the last minute. In particular, we've got the purchases there who's all geared up to do say chair acquisition, but I think we're where I've seen changes maybe is where there are assets in the company that the shareholders want to keep, but they hadn't thought about that before.

Maybe there's a warehouse that they've owned, and their granddad owned this warehouse, and this has been in the business for years, and they never thought they were going to sell it and in their mind, what was going to happen is the purchaser is going to buy the business and rent the warehouse. And then at the last minute, they realize everything's in the wrath of the company, and they're selling the shares. And then they have to do a U-turn on that. And then you're trying to get to a position where you've got the sale of the assets of the company, then the company you're looking at whether or not you can have the concessions there you were looking at whether you can pass that concession out to the shareholders, and how you pass that out to the shareholders.
And then you're looking whether you have an individual in the business, you can meet the concessional shareholder conditions as well. And that's a whole other story, that one, but you know, there are lots of different issues there that will be going on. But, you know, if you're, if you're thinking about selling your business, then getting these kinds of questions answered quite early on and getting these kinds of reviews done. I think, for my experience anyway, it

puts you in a much stronger position with the purchaser. Because if you're trying to sell a business, and you know you're showing the weakness of the purchaser because you're not really sure what you're doing and what you're selling, I'm not saying all purchasers pounce, but there is sort of a purchaser there who knows that this seller is not really sure what's going on. And sometimes they can manage to change things. And I do have a very, very sad story. But it's not related to Australian tax. But it is a sad tax story in relation to somebody who had a structure done to buy a business. And he was buying it from other shareholders because the shareholders had fallen out. And he wanted to stay, he wanted to buy the shares. So he could keep the employees on. And he wasn't going to profit from this.

So the idea was that he was going to buy the shares from the individual using the funds from the company. And there was a way in which you could do that. And they would have got capital treatment and everything would have been fine. Then at the last minute, an email came from the vendors to say, actually, we want to change the way we're doing this because our advisors are not sure how our beliefs are going to work. So what's going to happen is we're going to do the shares one way and then you're going to get the money out of the company a slightly different way. But at the end of the day, it still gives us the same answer on the bottom. Now, it did financially, if when you do the numbers give them the same answer on the bottom. But what this individual had failed to look at is actually there was a big anti-avoidance provision by changing that structure at the last minute. So this individual who was that purchaser ended up personally, with the tax bill of about 900 facets, oh, he hadn't received anything. Now this as I say, it's not an Australian tax case. But it is a reported case and in the UK, but it just goes to show that, you know, changing a deal at the last minute down really, really changed the tax consequences. And I think the saddest thing with this was the individual who had happened to was an accountant. So because he was an accountant, he didn't take tax advice because he thought, Well, I don't need to take tax advice because I'm an accountant.

So, you know, it was a really sad story. And it's one of those stories that can every time I say it, it does break my heart It is actually going to the Supreme Court in the UK, but I don't think it's going to be overturned because it just fell squarely in tanti avoidance and one phone call To a tax professional could have spotted it, it was a glaring error. It could have been picked up, it wasn't something that nobody would have known about. It was a novice error. So yeah, so that's, I suppose I digressed a little there. But it's just seeing something like that happen, those kinds of last-minute changes. It's just knowing the impact they're going to have on the tax position. Yeah. Because if you're the owner of the business, who's made the sale, you've changed the deal. at the last minute, you think you're getting the same tax consequences, you learn the information from your accountant to do your return and they tell you you have a tax liability that you weren't expecting.

Joanna: Yeah, absolutely. And it's just about and I guess, you know, we talked about these in the last episode, but just to reiterate, it's about early planning, regular reviews and regular planning, and then that proper planning at the end, where you have your advisors working together, as a team, you know, this is something that I talk about a lot, but I just think it's so important that you know, the lawyers on a deal and the accountants and the broker don't work in silos, everyone needs to work together. Because when you change one element, sometimes that can have a really big impact on other elements. So ultimately, when you're working as a team, however, in these transactions, you've got all of those eyes who are looking at it from all of those perspectives and going on that journey together to protect you.

Paula: Yeah, exactly. Joanna, you know, at the end of the day, everyone's on the client-side. Yeah, so everyone needs to be pulling together. And I don't know about you, but my experience in transactions is if I solve a tax problem, then another problem pops up somewhere else, it's like the toy with the hammer.

Joanna: Oh yeah, whack a mole.

Paula: Yeah, that's what it's like, I saw the tax problem and the legal problem pops, problem solved. And then some commercial problem pops up somewhere else. It is about having that collaborative approach where everyone's working together and knowing that we're all on the side of the client.

Joanna: Yeah, absolutely. And I think, you know, ultimately, that just provides the best outcomes. And also, I find in those instances, you also have clients who are closer to the journey, because it can be very confusing for clients at the end of the day, if they have one sort of messaging from their lawyers, and then they go to their accountants who then come back with another myth, you know when they and they're sort of in the middle. So I think when we can have that deal team together, it just, it's, it's better for everyone.

Paula: Oh, absolutely. Because at the end day, you don't want the client as a middleman between the advisors. And, you know, working with a client and the advisors. It's not a point-scoring exercise. Yeah, it's about making sure you get your client over the line, but the money in their pocket the legal are right, the taxes, right, and the commercial stack up? Yeah, it's about having all of that together at the same time.

Joanna: Yep. I totally agree. And you know, that our larger clients, I think, for larger businesses, that is a that is obvious it's for SMEs who don't normally perhaps feel they have access to this integration of advisors, where they miss that this is, this is something for larger businesses that that is absolutely done. And that is obvious. They have all the professionals at the table. But SMEs need to understand how important it is for them too.

Paula: Yeah, I think so. And I think part of it stems from, you know, when you start out in business, things are tough. you're careful where you spend your money, you're trying to grow your business. And as that business grows, it's having a slight shift in mentality as to what is important, yes, you need to keep the growth going. But there are lots of things that need to happen in relation to structure and the legal side and everything else that needs to be addressed as you go along. And, you know, over the years, I've had clients who've had not said that didn't know how big the business was, but because there was so busy working, they actually had no new feel for how big their business had grown. And I remember one of them coming. And he was saying he wanted to buy a house and he told me how much this house was. And it goes on, I'm just working out where I'm going to get the money. And I said You have three times that in your company bank account. But I need that in the business. I'm like, you don't, you don't need it in the business. And he had been taken a modest salary, living in a modest house living a very modest life. And his company was building up this incredible wealth, but he didn't see it because he was doing the day to day business working with the guys that were doing in construction and he hadn't got a feel for just how big his business had grown. I love those kinds of people because I find so refreshing as well.

Joanna: Yeah, I know.

Paula: Once you have them on the page that this is what you need to look at, then they appreciate it and understand it. But you know, it's not always obvious when you've got your head down growing a business.

Joanna: Oh, absolutely. We've got some clients like that. And it's, it's beautiful stories when you can be part of that realization as well. And ultimately, I think the exit is quite often that beautiful picture of that realization. And it's not always the case, though, because sometimes, you know, sellers have a higher opinion of the value of the business and the market does. And sometimes things like tax getting in the way.

Paula: Yeah, that opinion on the value can be quite difficult. And I used to use a lecture on selling businesses. And I used to do this lecture with this corporate finance person. And his lecture was seven deadly don'ts of selling a business. And he used to go through these things. But the one thing he used to always say goes, don't name a price. Because the minute you name a price, you've put a ceiling on what you're going to get for your business because you don't actually know what someone is thinking about paying for your business. And it could be that your business fits strategically with them in a way you're not imagining, you're just doing x times turnover x times profit because that's what the market does. But you might have a niche or something different. Yes, you need to get your business valued. But, you know, it's always well, what are you willing to pay me you put the offer to me, don't put the offer out to them? That's what I think anyway, and it was always a very valuable lesson.

Joanna: Yeah. Well, and I guess we were also talking about, you know, negotiation strategies, but also about sitting in the seat of your buyer and understanding what might be important to them what they might be thinking. And, you know, coming back to this question about the sale, I guess, when when we looking at the structure of a sale, and the tax consequences, and then working out, you know, what we need to get our buyer across the line for it really helps if we understand what's important for them, you know, in order for us to build the story, so that they can fit into our approach for what makes the most sense from a tax perspective. But the first step is understanding what that is.

Paula: Yeah, it is.

Joanna: Wonderful, Paula? Well, look, I just want to say a massive thank you for coming on to the deal room podcast for these last two episodes. It's such an important topic, this whole topic of tax. And it is so important that we are in fact running a webinar, particularly about these topics. And we're going to be talking about the expensive mistakes when selling your business, we're going to be looking at tax. And we're going to be looking at a number of other things from a legal perspective as well. So make sure you tune into that webinar all about the expensive mistakes when selling your business so that you're not making some of those expensive mistakes. And of course, if you miss the live event, have no fear, it will be available for you on demand. Of course, you won't be able to come with your questions, but you will be able to reach out to Paula and me afterwards if you want to discuss your questions. Now. Paula, how do people contact you if they would like to have a discussion about tax planning in their business?

Paula: Well, they can email me at PTallon@prosperity.com.au. And I will always call you back because I love a good conversation about tax.

Joanna: I love that. That is fabulous. Look, I've had so much fun. Thank you so much for coming to the show today. Paula. I've really enjoyed having you and I'm super looking forward to our webinar all about expensive mistakes to avoid when selling your business. Thanks, Paula.

Paula: Thank you.

Joanna: Well, that's it for our two-part series, all about tax, small business CGT concessions and of course war stories with Paula Tallon, the Director of the taxation of Prosperity Advisers Group. Now, don't forget, we have a webinar coming up very soon, all about the expensive mistakes to avoid when selling your business Paula, we'll be talking about the tax implications and mistakes to avoid. And I'll be talking about the legal areas to look out for. If you missed that live webinar, don't worry, you can still access an on-demand version. To register for either the live or the on-demand version, head over to the show notes, where you'll get a link straight through to the registration page. And if you'd like more information about this topic, or to register and you can't access the show notes, then head over to our website at www.thedealroompodcast.com and find this episode, which is part two of this two-part series with Paula and I talking about tax. And you'll also be able to download a transcript of this podcast episode if you'd like to do that. And of course, there you'll be able to register for the webinar that we have coming up and the benefit of turning up live is you'll also be able to ask questions which will answer live on that webinar. Over on our deal room podcast episode page. You'll also find details of how to contact the fabulous Paula Tallon if you'd like some assistance with any of your tax planning and of course, you will also find details of how to contact our legal Eagles at Aspect Legal if you or your clients would like to discuss any legal aspects of sales or acquisitions. Well, that's it I hope to see you at the webinar. It's going to be a lot of fun. And otherwise thank you again for listening in. have loved to have you on the show. I hope you enjoyed it as well. You've been listening to Joanna Oakey and The Deal Room podcast, a podcast proudly brought to you by our commercial legal practice Aspect Legal. See you next time.