Legal aspects of succession planning

When you are starting a business, you should also consider when and how you wish to get out of the business. For example:

- Do you want to run the business alone for a number of years and then close the business down?
- Do you want to start running the business alone but aim to grow the business to a point where it can be operated by your employees and you can take a step back?
- Do you want to keep the business within the family for it to be passed down from generation to generation?

Your answers to the above questions will determine what structure you should use to set up your business.

If you set up your business as a **sole trader**:

- You will have no ability to split the income that you receive from the business with your spouse or family member, as you would have if you operated your business through a trust or company (see below); and
- There will be a lack of continuity and missed potential for growth in respect of this structure because a business is conducted by a sole trader it cannot expand beyond the sole trader. If you want to expand your business by taking on an investor or a new partner, you will have to change its structure to a partnership, trust or company structure.

If you set up your business as a **partnership** with other co-owners:

- You will have flexibility in respect of the distribution of the partnership's income between the partners; however
- There is a lack of continuity in respect of this structure because partners cannot transfer their share in the partnership to anyone outside the partnership unless the other partners agree. It is therefore very important that, when you set up or buy your business, you and your partner(s), agree on what the procedure will be if one person wants to leave the partnership. You should document these procedures in your partnership agreement.

If you operate your business through a **company**:

- You will have less flexibility in relation to the distribution of income amongst the company's shareholders than you would if your company was set up as a trust or a partnership because a company will usually have to pay all shareholders the same dividend; however
- The company structure can ensure continuity of management and ownership in the event of death or disability of the key people of the business because a company's shares are easily transferable;
- A company is an excellent vehicle for growth, as it is quite a simple matter to take in an investor who will usually have a clear understanding of receiving issued shares in return for part ownership of the business; and

- You can also use a company structure to effectively separate the management and ownership aspects of your business. For example, the managers of the business may be appointed directors of the business and the owners of the business can be shareholders of the company.

If you operate your business through a **trust**:

- You will have a large degree of flexibility for tax purposes. For example, a discretionary trust provides flexibility in relation to the distribution of income and capital gain amongst the trust's beneficiaries, which are usually the business principal and his or her relatives; however
- There is also a lack of continuity in respect of this structure because a trust is a very poor vehicle by which to grow a business beyond a certain point. This is because a trust does not easily accommodate a business that is managed by numerous people.

From the above, you can see that some structures lack flexibility and continuity. When setting up a business it is a good idea to discuss your exit strategies with your professional advisors and obtain their advice on the best structure for you and your business. Your exit strategies should be documented in your business plan.

Who do you want to pass on your business to?

You should identify who it is you want to sell your business to, for example:

- A family member.
- Management.
- A key employee.
- A competitor.
- A related business.

Who you intend to sell your business to will affect, amongst other things, the legal documentation necessary to effect the sale of your business together with the taxation consequences of the sale. Your professional advisors will be able to advise you in this regard.

What do you want to pass on?

When you decide to sell a business there are generally two ways to do so, namely:

1. Sell the assets (commonly referred to as a 'sale of the business'); or
2. Sell the structure that conducts the business, that is, sell the shares (if a company is conducting the business) or sell the units (if a unit trust is conducting the business).

If you are conducting your business as a sole trader or through a partnership you cannot sell the structure through which your business operates. A sale by all the partners of a partnership will fall within the first option as will a sale by a sole trader of its business.

Tax consequences

There will be differing tax consequences depending on how you choose to sell your business. For example:

- when a business is sold as a going concern (which means that you sell the purchaser everything they need to continue carrying on the same business as you did) there may be no Goods and Services Tax ("GST") payable on the purchase price of the business; or
- alternatively, if you sell all of the shares in the company that runs your business, the stamp duty that the purchaser will pay on the purchase price of the shares may usually be less than the stamp duty payable on the sale of the assets of the business.

It may even be necessary for you to restructure your business operations prior to the sale of your business to achieve the most tax optimal outcome. For this reason it is important that you consult your accountant if you are thinking of selling or passing on your business to ensure that you do so in the most tax efficient manner.

Further information

The above is only an overview of what you should take into consideration when planning the life-span of your business. There will be other considerations relevant to the specific nature and circumstances of your business and other aspects of your financial affairs. For more personalised guidance about your options on the sale of your business, we recommend that you consult with your legal and taxation advisors.

The following fact sheets provide further information on these issues:

- Business planning
- Develop a succession plan
- Set up as a company
- Set up as a partnership
- Set up as a sole trader
- Set up as a trust
- Tax implications of a company
- Tax implications of a partnership
- Tax implications of a sole trader
- Tax implications of a trust