WMC accounting

YOUR Knowledge

The risky business of dying

Why the death of your business partners can have dire consequences

Imagine this scenario…. Michael, James, and Nadine are shareholders in a successful business, MJN Solutions. The shares in the company are fairly evenly split reflecting the contribution that each has made to the business, with Michael and James each holding 35% and Nadine holding 30%. They have been working together for years to build the business to its current level. The business is now worth around $4 million and is still on a growth path. While no one is related to each other, everyone is close. They have had their disagreements but they trust each other and respect each other's ability. It's a fairly common scenario.

But one morning Michael and Nadine are shocked by a call from James' wife Monica, telling them that James has died in a car accident.

If you are in business with shareholders, your business faces a major potential threat and its shareholders unexpected personal costs, if one of your fellow shareholders dies or becomes permanently disabled. And, the situation can be exacerbated where the shareholders are not related.

Good planning through buy/sell agreements and appropriate insurance can make all the difference.

For many businesses, if no pre-existing arrangements are in place, the death of a shareholder can mean having an unknown person (the beneficiary of the shares) actively involved in the business or an unwilling shareholder. The alternative is for the original shareholders to find the cash, then and there, to buy back the shares. Think about the value of your company…do you have enough cash to quickly fund the buy back for another shareholder?

What does a buy/sell agreement do?
Many companies do not have a plan in place that contemplates the untimely death of its shareholders or a break-up of the shareholders, and as a result, do not have buy/sell agreements in place.

Buy/sell agreements are legal documents that define what happens in an event that may trigger the disposal of a shareholder's interest in a company. Amongst other things, the agreement determines how the company will be valued, and how shares can be disposed of in a series of scenarios including death.

Outcome 1 – Nothing planned
Michael and Nadine have a problem beyond dealing with the demise of a close friend and trusted professional in the business. While everyone knows that the unexpected can happen, nothing was planned or put in place to manage a worst case scenario.

Tax - the new spectator sport?

Who would have thought that the passage of legislation through the Senate would become a spectator sport? The highly anticipated new composition of Senators sat for the first time in July with the Government's Budget reforms before them.

The key item of legislation to actually pass the Senate was the Carbon Tax repeal. The legislation contains measures to strengthen the Australian Competition and Consumer Commission's (ACCCs) position to pursue businesses that do not pass on savings from the carbon tax repeal. Specifically, the ACCC will now require electricity and natural gas retailers and importers of bulk synthetic greenhouse gases to prove their efforts to pass on cost savings to customers.

The Government's push to remove the mining tax and the myriad of spending measures associated with it – the loss carry back rules for companies, the slowing of the superannuation guarantee increase, the $5,000 instant motor vehicle deduction for small business, and the generous instant asset write off threshold also for small business – failed. So to did the legislation to encourage the privatisation of State assets (known as asset recycling).

With some of the budget measures retrospectively applied to the 2013/2014 income year, it will be interesting to see what happens form here as many of the measures may significantly affect the tax outcomes for business. We'll keep you posted.

Quote of the month

"We know what we are, but know not what we may be."
William Shakespeare

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The risky business of dying ......*continued*

James' shareholding and the rights that come with it, transfer through his estate to his wife Monica. Monica however wants nothing to do with the business that consumed so much of her husband's time. She just wants to cash out the shares and get on with her life.

MJN Solutions is still on a growth path and does not have the cash available to buy back James' shares. This means that Michael and Nadine now need to personally fund the purchase of Monica's shares (assuming they can come to an agreement about what the company is really worth). If they are unable to come up with the money, then Monica will become an unwilling shareholder.

Outcome 2 – Pre planning

Michael, James and Nadine worked with their accountants to put a buy/sell agreement in place to manage succession and unplanned events, such as the death of one of the shareholders. The buy/sell agreement defines how MJN Solutions will be valued and how the equity will be managed. In this scenario, the buy/sell agreement states that James' shareholding will be purchased by Nadine and Michael if James dies or becomes permanently disabled.

During the planning process, the funding arrangements necessary were put in place should the buy/sell agreement be triggered. In this scenario, Michael, James and Nadine opt to manage the funding through an insurance policy taken out in their own names (another way would be to fund the policy through a self managed superannuation fund - although there may be changes in this area with the ATO flagging that they will soon release their position on insurance held through superannuation for buy/sell agreements. Whichever way you go, it will be important to get current, structured advice in this area.)

When James dies, the insurance proceeds are used to purchase James' shareholding. As a result, neither Michael nor Nadine are out of pocket or take on debt, they own an increased share of the business, they avoid having an unplanned shareholder running the company, and they can get on with business.

Rental property expenses – what you can and can't claim

It's not uncommon for landlords to be confused about what they can and can't claim for their rental properties. What often seems to make perfect sense in the real world does not always make sense for the Australian Tax Office (ATO).

In general, deductions can only be claimed if they were incurred in the period that you rented the property or during the period the property was available for rent. This means a tenant needs to be in property or you are actively looking for a tenant. If, for example, you don't put a tenant into the property so that you can renovate it, then you might not be able to claim the expenses during the renovation period if it was not rented or available for rent during this time (there are some exceptions to this general rule). There needs to be a relationship between the money you make and the deductions you claim. Here are a few common problem areas:

Travelling to inspect your property

You can claim the cost of travelling to inspect your rental property. For example, if you fly interstate to inspect your property, stay overnight then fly home, you can claim the full cost of the trip. If however, the purpose of the travel is a holiday and the inspection is incidental to it, the trip is non-deductible except direct expenses and a reasonable portion of your accommodation.

Interest on bank loans

Only the interest on repayments for investment property loans, and bank charges, are deductible - not the actual loan itself.

Repairs & maintenance

Expenses you incur for repairs and maintenance are deductible if the expenses relate to wear, tear, damage through rental activities.

If the repair improves function or if it replaces an entire structure (e.g. a whole fence as opposed to repairing damaged palings), it's unlikely to be deductible but will be capital and depreciated over time.

Rental income from overseas

If you are an Australian resident, the ATO looks at your worldwide income. This means that if you own rental property overseas, you have to declare any income earned in your tax return - even if you have lodged a tax return and paid tax on the rental income in the country where the property is located.

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