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Planning for the Unexpected: "Business Pre-nuptials"

Introduction

"Pre-nuptials" is a term heard commonly these days in relation to an up-coming marriage. But what about two people in business together? What happens to them in the event of a "break-up"?

Of course a business break-up can occur in one of two ways. A voluntary break-up eg one of the business partners decides they have had enough - its time to retire or they just feel its time to pursue other opportunities. or ...

An unexpected departure by one of the owners eg death or total and permanent disablement.

Ironically, the time to prepare for these events is when you don't need to. That's where the "pre-nuptials" or business succession plan comes in.

This should be an essential for every business - yet our sources indicate that as many as 70% of Australian businesses don't have such agreements in place!

Business partners all too rarely plan for what will happen if one partner wants to exit the business voluntarily - leaving the business, and likely the friendship, at risk of a rancorous break-up.

In the event of an 'unwanted' exit, a departing partner's spouse often has to negotiate with the surviving partner. This can often be very difficult because of the difference in personalities, skills and indeed objectives which they each carry.

Careful planning can pre-empt these disasters by stipulating in advance, exactly how business equity will be handled if a partner chooses, or involuntarily, exits the business.

Key issues to consider for your clients

1. Having a set of agreements in place including an exit agreement for 'planned' exits or break-ups and a buy sell agreement for 'unplanned' exits.

2. Capital gains tax issues around the change in ownership or business structure need to be carefully managed. Different types of business structures attract different provisions depending on the owner of the equity, date of acquisition, acquiring structure of the equity, powers of appointment, insurance funding etc

3. The impact if either partner is a key person in terms of the income that they generate for the business or the capital value that they would 'take with them'.

4. Consider the business structure to ensure that the equity owners [which may or may not be the principals] are covered by the legal documents.

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5. How will the purchasing partner find the funds to meet the needs of the outgoing partner's families?

6. If insurance is used to fund the buyout, care must be exercised regarding who pays the premiums - there could be tax implications if paid by the business.

7. Any existing agreements in place eg sale agreement, need to have their terms and conditions incorporated into new business succession agreements otherwise they may be invalid.

8. Ensure that the Wills contain provisions dealing with the rights and obligations of the legal documents, otherwise the executor of the Will could be left with a nightmare to unravel over the ensuing years.

9. Consider the impact of discretionary trusts as they offer a completely different solution to capital gains tax problems at the time of death.

10. The deceased estate does not pay CGT but CGT liability remains an issue for the family beneficiaries so estate planning generally needs to be handled with care.

The obvious

It's far easier to negotiate an agreement when each partner is on a level playing field, than when one is at a distinct disadvantage. This is obviously exacerbated in the instance of a death when the surviving partner has to deal with an executor of the estate.

Exit Agreements: set out the rights and obligations surrounding the planned departure of a co-owner.

Buy Sell Agreements: help create a smooth and painless transition of ownership in the event of an unwanted event such as death or disablement of a co-owner.

Checklist: Do I Have Clients Who Need a Business Succession Plan?

1. Do any of my clients have two or more owners in their business?

2. What would happen in the event of one of them deciding to leave?

3. Would the remaining partner want to buy the business?

4. How would they fund it?

5. For how long could the business "carry" a principal after an unplanned event eg during a critical illness, or worse still, for how long could they support their family after death?

6. In the event of a death, would the surviving spouse want to come in and replace their partner? How would the surviving business partner feel about that?