

“Business Succession Planning and Equityholders Agreements”

Presented by
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Director

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Tom has over 30 years' legal and business experience including:

- Previously working for local law and major national firms;
- Being majority-owner and executive director of his former mid-tier firm;
- Being the national operations manager for a financial advisory IT platform provider;
- Previously being the WA Legal Technology Group Manager for a National Law Firm
- Owning and managing an IT consultancy business; and
- Being a director and in-house counsel for a public company.

continued...



Tom is also a regular publisher of articles and is one of Australia’s leading presenters of legal seminars to and for various professional bodies, associations and government authorities on a wide range of business law and professional development-training topics including:

WA Department of Commerce	Institute of Public Accountants	CPA Australia
Chartered Accountants Australia & NZ (CAANZ)	Governance Institute of Australia	Mortgage & Finance Association of Australia (MFAA)
Law Society of WA	National Electrical & Communications Assoc (WA)	City Insolvency Discussion Group
Innovation Centre of WA	Australian Hotels Association (WA)	Forum for Directors of Indigenous Organisations (FDIO)
LegalWise CLE	Small Business Development Corporation	Stirling Business Centre
The Tax Institute	Australian Institute of Conveyancers (WA)	Institute of Certified Bookkeepers
Western Suburbs Business Association	Business Foundations Inc	WA Business Assist
Strata Community Association of Australia	Real Estate Institute Western Australia (REIWA)	Australian Institute of Business Brokers (AIBB)

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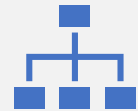
Content Summary



What are your options when retiring from your business?



Structuring your business for the future.



Managing the succession process.



Maximising your retirement wealth/Asset Protection Strategies.

Sobering Statistics

- Currently undergoing a major generational change in business with a number of 'baby boomers' now reaching retirement (5.5 million Baby Boomers = 25% of population).
- Less than 1/3 of family businesses now continue into the 2nd generation.
- Less than 16% of businesses survive to the 3rd generation.
- Less than 30% of business owners aged between 51-60 have a written business succession plan.
 - For 4 male business partners all aged 35, the probability that one will die or become totally and permanently disabled before the age of 65 is 77%.
 - With 6 partners the probability increases to 89%.

What is Business Succession Planning?

A Will and an Enduring Power of Attorney are of assistance for personal death or illness, but what happens to your business/equity?

- Voluntary (i.e. managed succession):
 - Sell your business/equity; or
 - Retire.
- Involuntary (i.e. crisis succession)
 - You or your business goes into liquidation/bankruptcy;
 - Divorce;
 - Loss of required business license;
 - Criminal charges; or
 - Death or TPD.





What are your Options when Retiring from your Business?

- What could "retiring from business" mean?
 - Ceasing to work in the business (e.g. as an employee or consultant);
 - Ceasing to control the business (e.g. as a director or partner); or
 - Ceasing to own the business (e.g. as a shareholder or partner).
- What about "retiring your business"?
 - Sale of your business or equity; or
 - Winding-up a company/ trust or
 - Dissolution of partnership; or
 - Liquidation, bankruptcy or death!

What are your Options when Retiring from your Business

“Cash-out” through Sale of Business (e.g. on the open market, sale to a competitor or management buy-out/in)

Sale of Equity (e.g. shares or units) to third party or remaining equity holders, if any

Equity buy-back (by Company) or redemption (by Unit Trust)

Prepare for Public Listing (i.e. Initial Public Offering—IPO via Prospectus and AFSL Licensee)

Family succession - if it is appropriate to pass down the business through the family (Family Business Association of WA)

What are your Options when Retiring from your Business?



- 'Funded' succession (i.e. Key Person insurances and Equity Holder Buy/sell Agreements using Life & TPD insurances);
- Closing down the business/ winding-up the company or vesting the trust;
- Dissolving a Partnership.



What are the possible tax outcomes?

- Tax outcomes from a sale can be vastly different depending on the business structure and the method of disposal (i.e. Share sale v Asset sale)
- Are the business assets pre-CGT? More importantly... if they were... are they still?
- What options do you have to reduce the tax on the sale (e.g. 50% discount, Small Business concessions)
- Get the right advice before you sign... date of contract versus settlement!

Key Person Insurance vs. Buy-Sell Insurances

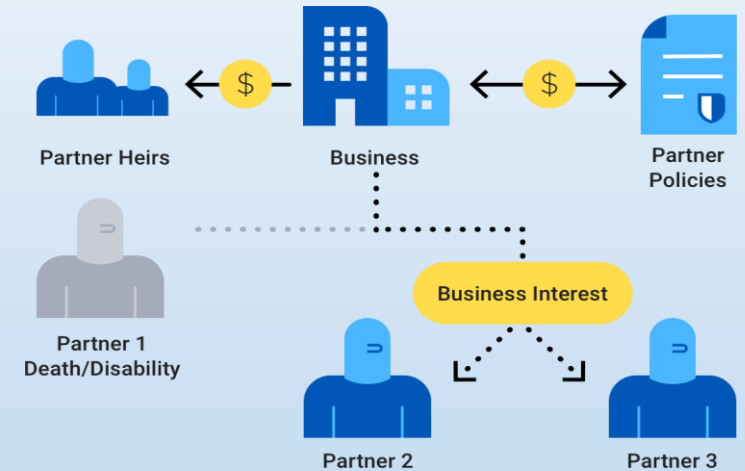
Key Person Insurance and **Buy-Sell Insurance** serve different purposes within a company, especially in the context of shareholder buy-outs due to death or Total and Permanent Disability (TPD). Here's some reasons why Key Person Insurance is not suitable for funding buy-outs and the legal, financial, insurance, and tax considerations involved.

Key Person Insurance

- **Purpose:** Provides financial protection to a business against the loss of a key individual due to death, disability, or critical illness.
- **Usage:** The payout is used to cover expenses such as hiring and training replacements, compensating for lost revenue, or paying off debts.
- **Tax Treatment:** Premiums are generally tax-deductible as a business expense, but the payout is typically taxable as income.

Buy-Sell Insurance

- **Purpose:** Facilitates the buy-out of a deceased or disabled shareholder's interest in the company.
- **Usage:** The payout is used to purchase the shares of the deceased or disabled shareholder, ensuring a smooth transition of ownership.
- **Tax Treatment:** Premiums are not tax-deductible, but the payout is generally tax-free if structured correctly.



Key Person Insurance

[kē 'pär-sən in-'shür-ən(t)s]

A life insurance policy that a company purchases on the life of an owner, a top executive, or another individual considered critical to the business.

Investopedia

Key Person Insurance vs. Buy-Sell Insurances cont'd

	Key Person Insurance	Buy-Sell Insurance
Purpose	Protects business from financial loss due to key person's death or disability	Facilitates buy-out of deceased or disabled shareholder's interest
Usage	Covers expenses like hiring replacements, lost revenue, debts	Funds the purchase of shares from deceased or disabled shareholder
Tax Treatment (Premiums)	Generally tax-deductible as a business expense	Not tax-deductible
Tax Treatment (Payout)	Taxable as income	Generally tax-free if structured correctly
Legal Framework	Not specifically addressed by Corporations Act	Governed by contract law and must comply with Corporations Act
ATO Guidelines	Premiums deductible, payout taxable	Guidelines ensure tax-free payout if structured correctly

BENEFITS OF A BUY-SELL AGREEMENT WITH LIFE INSURANCE

BUSINESS CONTINUITY

Buy-sell agreements funded with life insurance can ensure that a business continues to operate effectively in the event of the death of an owner or partner, providing stability for employees and customers.



SEAMLESS TRANSITION

In considering a buy-sell agreement with life insurance, the planning involved can help to prevent disputes and support a seamless transition in the event of an owner's untimely passing.



EQUITABLE DISTRIBUTION

Buy-sell agreements with life insurance can help to provide an equitable distribution of business assets in the event of the unexpected death of an owner, avoiding inheritance issues.



FINANCIAL SECURITY

In considering a buy-sell agreement with life insurance, the funding provided can ensure financial security for both the surviving family members and business partners of a deceased owner.



Business Structures' Succession Arrangements



Sole traders

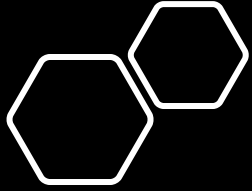
Personal estate asset therefore by Will (or, eventually maybe, by Letters of Administration!)

- Contractual Options (recommend registration on PPSR) or Gift. Terms to pay off estate?
- *Hint: Consider income protection insurance in lieu of inability to obtain Worker' compensation insurance.*

Partnerships

By written Partnership Agreement or (automatic) dissolution pursuant to s. 44 of the *Partnership Act (WA) 1895*:

- (1) *Subject to any agreement between the partners every partnership is also dissolved by the death or bankruptcy of any partner....*
- (3) *The dissolution shall take effect from the date of the death, bankruptcy, or notice as the case may be.*



Business Structures' Succession Arrangements

- May actively hold business assets or be a 'passive' equity holder (e.g. of a trading company or unit trust).
- Note succession is via the Appointer not the Trustee.
- Hint: watch for Perpetuity Period (usually 80 years) expiring! This may trigger a deemed capital gain!
- Consider updated Family Trust succession provisions for, say, multiple, successor adult children:
 - Appointed jointly;
 - Mandated to act unanimously; and
 - Dispute resolution' provisions are incorporated e.g. must notify each of any disputed issue(s) first, then required formal mediation and only after that can the Courts' involvement be sought.

Business Structures' Succession Arrangements

Unit trust

Unit holder Agreement (note: not the Unit Trust Deed)

Company

Shareholders Agreement (note: not the, rudimentary, Articles or Constitution)

TIP – Deeds of Co-Ownership

For any real or personal property owned as tenants in common (i.e. a commercial investment property or valuable asset e.g. vintage car).



Equity Holder Agreements

1. Definitions and Interpretation
2. Good Faith
3. Allotment and Transfer of Shares
4. Management and Operation of the Company
5. Company's Funding
6. Company Policies
7. [Pre-emptive Rights](#)
8. Drag Along Rights
9. Tag Along Rights
10. [Sale of Equity Following a Succession Event](#)
11. [Establishing Market Value](#)
12. Restrictive Covenant
13. Confidentiality
14. Guarantee and Indemnity
15. Bank Account
16. Encumbrances
17. Agreement to Prevail
18. Further Assurance
19. Notices
20. Default in Payment
21. Need for Execution by Attorneys
22. Party's Obligations
23. Charges and other Dealings
24. Variation
25. Termination
26. Dispute Resolution
27. Duty, Taxes, Costs and Expenses
28. Dividend Policy
29. Binding Effect
30. Time of the Essence
31. General
32. Special Conditions

Pre-Emptive Rights (aka 'various exit options')

1. PRE-EMPTIVE RIGHTS ON VOLUNTARY SALE OF EQUITY

1.1. Definitions

In this clause:

- (a) **Acceptance Notice** means a notice given to the Company by a Shareholder in accordance with clause 1.6;
- (b) **Offer** means an offer made to each Shareholder in accordance with clause 1.4;
- (c) **Purchaser** means a Shareholder accepting an Offer;
- (d) **Third party Purchaser** means a person other than an existing Shareholder, to whom a Vendor may Transfer all or part of its Equity in accordance with this clause 7;
- (e) **Sale Notice** means a notice given by the Vendor in accordance with clause 1.3;
- (f) **Subsidiary** means:
 - (i) a company or unit trust in which a Shareholder solely holds more than 50% of the voting rights; or
 - (ii) a discretionary trust for which a Shareholder controls the appointment of the trustee; and
- (g) **Vendor** means a Shareholder who intends to sell all or part of its Equity.
- (h) **Voluntary Price** means the price of the Vendor's Equity at which the Vendor proposes to sell;

1.2. Transfer Restricted

No Shareholder may Transfer the whole or any part of its Equity except in accordance with this clause 7.

1.3. Sale Notice

A Vendor who wishes to Transfer of any or all of its Equity must first give a Sale Notice to the Company offering to sell that Equity to the other Shareholder and specifying:

- (a) the portion of the Equity that the Vendor proposes to Transfer;
- (b) the Voluntary Price, subject to clause 7.13 below;
- (c) the manner of payment of the Voluntary Price; and
- (d) all other terms or conditions of sale,

appointing the Company as the agent of the Vendor for the sale of the Equity at the Voluntary Price.

1.4. Offer

Within fifteen (15) Business days of receipt of a Sale Notice the Company must give notice to each Shareholder (other than the Vendor) by sending a copy of the Sale Notice to each Shareholder. The Sale Notice when given constitutes an Offer by the Vendor to that Shareholder to sell the Equity on the terms and conditions specified in the Sale Notice.

1.5. Time Offer Remains Open

Each Offer will remain open for acceptance for one (1) month from the date it is made unless declined before the expiry date of that period.

1.6. Acceptance of Offer

Equity Holder Agreements

Succession Event the occurrence of which will result in payment of the Purchase Price being calculate date the rate of 75% of the then Market Value	Option held by Retiring Shareholder	Option held by each Continuing Shareholder	Time by which Option must be exercised
1. If a shareholder's Equity has become the subject of an enforcement process (e.g. PSSO) following a judgment debt of \$10,000 or more and which debt is neither the subject of appeal or discharge within thirty (30) days of date of judgment.	Sell Option	Buy Option in respect of a proportion of the Retiring Shareholder's Equity which is equal to the proportion that the Continuing Shareholder's Equity bears to that of other Continuing Shareholders.	Three (3) months from the Succession Date.
2. If a Shareholder or its related Director or employee (as the case may be) breaches any Essential Terms of this Agreement and fails to rectify the breach within fourteen (14) days of written demand to that effect by the other Shareholders or the Company.			
3. If a Shareholder or its related Director or employee (as the case may be) is convicted of an indictable offence leading to a possible prison sentence of 12 months or more			
4. If a Shareholder or its related Director or employee (as the case may be) is guilty of unprofessional conduct resulting in the cancellation, suspension or restriction of their relevant license or practising certificate in Western Australia or any other jurisdiction.			
5. The bankruptcy or liquidation of a Shareholder or related Director or employee (as the case may be).			
6. If a related Director or employee (as the case may be) is, by the unanimous decision of the other Shareholders, dismissed from their employment by the Company for breach of employment by serious misconduct.			
7. If a Shareholder or its related Director or employee is absent from work for more than 3 months, other than in respect of any leave entitlements.			

Succession Events

Succession Event the occurrence of which will result in payment of the Purchase Price being calculate date the rate of 100% of the then Market Value	Option held by Retiring Shareholder	Option held by each Continuing Shareholder	Time by which Option must be exercised
1. If a Shareholder's related Director or employee (as the case may be) has, by reason of unsoundness of mind or of ill health, become incapable of being involved in Full Time Employment for a continuous period of six (6) months or more.	Sell Option	Buy Option in respect of a proportion of the Retiring Shareholder's Equity which is equal to the proportion that the Continuing Shareholder's Equity bears to that of other Continuing Shareholders.	Three (3) months from the Succession Date.
2. If a Shareholder's related Director or employee (as the case may be) dies.			
3. If a Shareholder's related Director or employee (as the case may be) is married or has been living with a partner in a marriage-like relationship with a person of the same sex or different sex (or howsoever described) or a de facto relationship as defined by a Commonwealth, State or Territory law, and begins to live separately and apart from her or his spouse or partner in a manner that constitutes a separation for the purposes of a Commonwealth State or Territory law, and has not settled within three (3) months of their separation, by way of court order or financial agreement, the financial claims or rights arising from the relationship of both the individual and her or his spouse or partner.			
4. If a Shareholder is unable to provide the monies as required pursuant to a Drawdown Notice issued in accordance with clause 5.4 of this Agreement.			

Establishing Market Value

11. ESTABLISHING MARKET VALUE

- 11.1 To facilitate the Transfer of Equity (subject to clause 7), the Company shall instruct the Accountants to prepare interim Financial Statements and provide copies to all Parties to support the agreement or determination of the Market Value.
- 11.2 The Market Value of the Company, from which the Market Value of the Shares or the Shareholders' Equity can be calculated, under clauses 7.13, 9.3 or 10.4 (as the case may be), shall be agreed between the Shareholders, or failing agreement within three (3) Business Days of demand for determination of the Market Value from any Party to the other party or other parties, be determined by a person ("Valuer") in accordance with this clause 11.
- 11.3 The Valuer shall be a person as agreed between the Parties or failing agreement, the capable Parties must promptly request the Institute of Chartered Accountants Australia and New Zealand ("CAANZ") nominate a Valuer and failing which, as nominated by the President of the Law Society of Western Australia. The Market Value will be that determined by the Valuer nominated by the CAANZ or the President of The Law Society of Western Australia, as the case may be). If any valuer provides a range of values, then the mid-point of the range is taken to be the relevant Market Value for the purpose of this clause.
- 11.4 The Valuer:
- (a) must have at least ten (10) years' experience in valuing companies operating a business similar to the Business;
 - (b) acts as an independent expert and not as an arbitrator; and
 - (c) must comply with Australian Professional Ethical Standards No. 225 and such other standards of professional ethics as may apply to the Valuer.
- 11.5 The Valuer must adopt the method of valuation that the Valuer considers appropriate, but in valuing the Company, the Shares or the Equity, the Valuer must:
- (a) Assume that a reasonable time is available in which to obtain a sale of the Shares or the Company in the open market and for that purpose three (3) months will be deemed a reasonable time;
 - (b) Have regard to the following factors (in addition to any other factors which the Valuer believes should properly be taken into account) based on the best information available at that time:
 - (i) prospects of the Business;
 - (ii) the value, at a specified capitalisation rate appropriate to the Business, of the estimated future maintainable earnings of the Company;
 - (iii) the yield which an open market investor would reasonably require in an acquisition of the Shares or the Company;
 - (iv) the net tangible assets of the Company as disclosed in the Financial Statements preceding financial year or part of a final year, or if no accounts of the Company (prepared and approved by the Accountants) are available, as disclosed in the latest management accounts of the Company;

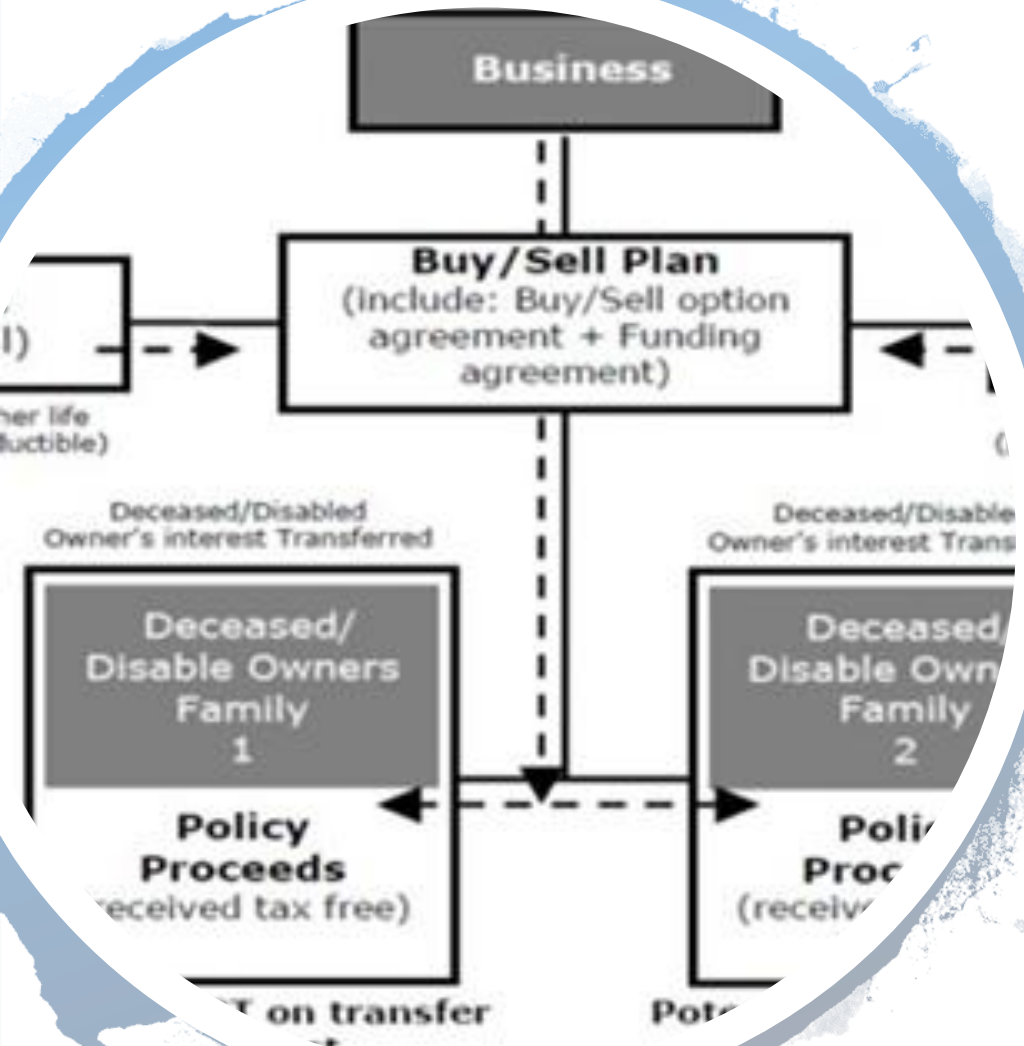


Buy/Sell Agreements

- Separate Agreement for Insurance-Funded Buy/Sell Agreement (not incorporated into an Equity Holders Agreement).
 - Note: must be an option agreement without consideration at time of signing not mandatory otherwise potential for immediate CGT-event trigger (s.104-35(2) of ITAA)
 - Essential that the Succession Event be a condition precedent to the formation of the Buy/Sell Agreement.
- Upfront agreed certainty of payments (funded by insurance) for specific events i.e. death & TPD only
 - Self owned (different to key person insurance) vs Cross owned
 - Trauma/ Critical (not appropriate for income protection)
 - Stepped or Level?
- Valuation methods (agreed in advance and linked to Equity Holders Agreement?).

continued...

Buy/Sell Agreements



- Fully-Funded or partial funded with possibility of Vendor Finance 'top-up' (e.g. 12 months with above method %);
- Waiting period to exercise option, e.g. 3 or 6 months (watch that shorter period may not be covered if dividends are being paid);
- Does the insurance discharge all the insured's liabilities as well as their equity's value?
- Note: Always obtain appropriate licensed insurance advice.

Managing the Succession Process

- Think of yourself, not as the founder but as the steward of your business.
- Do you do it in your 'twilight years' or sooner?
 - It's not uncommon for succession discussions and planning process to take years before something workable is agreed and properly documented.
- *Hint: succession planning should be in place right from the establishment of the business – because it's always going to happen!*
 - Incremental or full succession?
 - Incremental is not uncommon common in juniors buying-in and with some management buy-outs.
 - *Hint: in addition to them being able to afford\$ to buy their equity, ensure equity sale is linked to employment conditions, agreed KPIs and even the conditional passing of the AICD course.*

continued.....



Managing the Succession Process

- ✓ Threshold between level of equity holding and “control” e.g.
 1. Shareholding only below, say, 20%; and
 2. Only the entitlement to Directorship above 20% shareholding plus with associated personal responsibilities & liabilities!
- ✓ Market value discounting for early, voluntary succession (i.e. quitting!) by a new equity holder e.g. Say:
 - 50% reduction in 1st year;
 - 40% in 2nd year; and
 - 30 % in 3rd year, and so on.

continued...

Managing the Succession Process

- Restrictive/Protective covenants for exiting party
 - to protect goodwill component paid for business or equity
 - Vendor's related parties agree to restrict future employment, consultancies, investor TP interests.
- “Drag-along” and “tag-along” for third party buy-out offers.
- Forced sale to liquidate business/equity (i.e. “shotgun”!) clauses.
 - Firstly pre-emptive rights,
 - If waived, then sale offer to third parties (with ‘last rights of refusal’),
 - Then, if no TP offer, vendor must re-offer to remaining equity holders at say 20% reduction of initial offer price; and, lastly
 - Forced business/equity sale activates.

Thank You

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