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Strategy Document

Business Succession

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About the Contributors

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James is a highly qualified, award-winning Financial Planner and Executive Share Scheme (ESS) strategist advising executives, professionals, business owners and expatriates predominantly in mining and resources industries.

Craig Hong
Lawyer

Craig Hong has advised business owns and individuals in mining and resources since 2004. He offers insight and legal expertise in business structuring, intellectual property, commercial law, contracts advice, business sales and acquisitions and a raft of organisational matters that include HR and corporate governance.

Craig Barry
Chartered Accountant, Tax Specialist and Business Advisor

Craig Barry has worked with mining and resources professionals and executives for his entire professional life. He has the skills necessary to solve highly complex tax issues and is often called upon to interpret complex tax laws and government mandates.

Overview

Succession planning is a critical process for mining and resources business owners. As founders and owners look to step back from day-to-day operations, ensuring a smooth transition is not only paramount for the longevity and success of the business, but for all stakeholders involved.

In this document, Resources Unearthed expert collaborators Business Advisor and Tax Specialist Craig Barry, Financial Adviser James Marshall and Lawyer Craig Hong, explore the key issues business owners need to consider when planning for business succession. We'll delve into the complexities of this process and highlight the benefits of taking a long-term strategic approach to business succession, which can provide advantages for everyone involved.

Strategic Business Succession in Mining and Resources: Weighing Internal vs. External Leadership Paths

Succession planning is a critical process for mining and resources business owners. As founders and owners look to step back from day-to-day operations, ensuring a smooth transition is not only paramount for the longevity and success of the business, but for all stakeholders involved.

In the coming weeks, my expert collaborators Financial Adviser James Marshall and Lawyer Craig Hong will explore the key issues business owners need to consider when planning for business succession. We'll delve into the complexities of this process and highlight the benefits of taking a long-term strategic approach to business succession, which can provide advantages for everyone involved.

The decision between internal and external succession carries significant implications for the business's future, involving various financial, operational, and cultural considerations. This article explores key points that business owners should consider when deciding between internal and external succession options.

Is Your Business Succession Ready?

Before delving into succession options, it's essential to evaluate your mining and resources business's readiness for succession. Ask yourself, is the current business structure appropriate for supporting a smooth transition? This involves reviewing tax, legal, and operational structures to ensure they facilitate succession or acquisition.

Additionally, it is important to ensure that your internal processes are robust, as efficient processes are crucial for maintaining business continuity during the transition. Another consideration is whether the business is overly reliant on a few key personnel or the founder. A dependency on key staff can pose risks during succession, making it necessary to have a broader base of capable employees. Similarly, diversification of the client base is important; reliance on a few key clients or referrers can impact the business's stability during the transition.

Internal Succession: Preparing Future Leaders

Internal succession involves promoting current employees or family members working in your business to leadership positions. It is crucial that potential successors are genuinely interested in the leadership roles. Engage in open discussions to confirm their commitment. Assess whether these candidates have the necessary skills and experience to lead the business, possibly involving a trial period where candidates are given leadership responsibilities to gauge their performance.

From a financial perspective, consider whether the internal candidates have the financial means to buy into the business. If not, options like vendor finance or Employee Share Ownership Plans (ESOPs) can be explored. Vendor finance might involve simple Employee Share Schemes (ESS) for small to medium enterprises (SMEs).

Furthermore, determine whether internal candidates should receive a discount on their buy-in to reflect their contributions to the business. Implement safeguards to protect the business in case the succession plan does not work out as intended.

External Succession: Bringing in New Expertise

External succession involves bringing in new talent from outside your mining and resources business, potentially infusing fresh perspectives and skills. However, this option also presents challenges. Evaluating the capability of external candidates and understanding what attracted them to your

mining and resources business is essential. This assessment should cover their skills, experience, and potential to contribute to the business's growth. Ensuring that external candidates have the necessary capital to buy into the business is another critical factor. Financial readiness plays a significant role in external succession.

Cultural fit is another vital consideration; assessing whether external candidates align with the company culture is crucial for maintaining a cohesive work environment. The impact of external succession on internal candidates should also be considered. Addressing potential feelings of being overlooked and managing these dynamics helps maintain morale and productivity. Determining whether external candidates are expected to pay a premium to buy into the business and conducting an independent valuation can provide clarity and fairness in setting the purchase price.

Similar to internal succession, providing trial opportunities for external candidates to take on leadership roles in specific business segments can be beneficial. This allows the business to evaluate their capability for broader responsibilities. Implementing safeguards, such as buy-back clauses or phased transition periods, protects the business if the external succession plan doesn't succeed.

Transitioning to Family: A Delicate Dance

Passing your mining and resources business to family members is a sensitive task that involves more than just signing over the title. It's a complicated dance of managing family dynamics and ensuring fairness in the distribution of roles and benefits. This process also comes with legal and tax challenges. For example, giving your business or assets to family could lead to significant tax costs, like Capital Gains Tax.

Navigating Tax Implications

Australian tax regulations play a significant role in business succession planning. Key tax considerations for both internal and external succession include Capital Gains Tax (CGT), Employee Share Schemes (ESS), and stamp duty and other taxes. Transferring ownership can trigger CGT, and small business CGT concessions might be available to reduce this burden.

For internal succession, ESS can be a tax-effective way to transfer ownership to employees. Ensure compliance with tax regulations to maximise benefits.. Additionally, consider how the succession plan aligns with retirement strategies and maximising superannuation savings.

Combining Internal and External Succession

In some cases, mining and resources businesses may be in a position where they are considering a combination of internal and external succession. This approach leverages the strengths of both options but requires careful management to address potential complications, such as cultural fit and mutual respect between internal and external candidates. Clear communication and a well-defined integration plan are essential for success.

Business Valuation

Understanding your business's worth is critical for succession planning. This involves a detailed and realistic assessment of the company's financial health, market position, and future prospects. An independent professional valuation provides a solid foundation for negotiating the terms of a sale or transfer, whether to internal or external candidates. This process also helps in identifying any areas that need improvement to maximise the business's value before succession.

Business succession can be a complex process, so be prepared!

Effective business succession planning in the mining and resources sector requires a thorough understanding of both internal and external options, along with careful consideration of tax implications and strategic objectives. By preparing well in advance and seeking professional advice, business owners can ensure a successful transition and the continued prosperity of their business.

To learn more, please contact Craig Barry for a 20-minute no obligation discussion. You can call Craig on +61 90) 7 3007 2000 or email contact@resourcesunearthed.com.au.

To learn more about Craig, visit this link.

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This advice is general in nature, please seek professional advice specific to your circumstances.

Seven Critical Legal Considerations for a Smooth Business Succession Transition

Business succession can be a daunting proposition. Having worked so hard and for so long to build a successful mining and resources business, key legal considerations will help you transition from your business smoothly, in accordance with your wishes, and in a manner that will set you up financially for the rest of your life.

The most common methods for business succession are passing the business on to family, selling internally or to an external party. While your exit choice will depend on your individual circumstances, a number of critical legal considerations apply to all of them.

Here are our **seven critical legal steps** for a smooth and cost-effective business succession.

1. **Start Early**

The process of business succession is legally complex. Depending on your exit route, you'll need to address matters relating to finance, premises, suppliers, customers, and referrers before you can successfully transfer control of your business to someone else. Business succession should be considered as far in advance of actually exiting your business as possible, simply because careful legal planning requires time to achieve the best outcomes.

2. **Prepare the Business for External Sale**

Regardless of your chosen exit path, best practice will always be to prepare the business as though you are selling it to an external party with no prior knowledge of the business. This means undertaking a legal valuation, cleaning up and properly documenting any legacy issues that only you are aware of, ensuring that all systems and key agreements are written down and easy to understand, and presenting accounts in a form that are readily understood by third-party accountants. Your aim should be to ensure that whoever takes over the business – family member, internal or external buyer – is well-positioned to continue the operation smoothly.

3. **Consider the Structure of the Sale**

The business structure and whether you transfer the business itself or ownership of the entire underlying structure (such as shares in the company or control of a relevant trust) will have different – and very significant – legal implications for both you and the transferee. Given the number of potential permutations and combinations, the most appropriate structure for your sale will not always be clear. You will need proper financial planning, accounting, and legal advice to ensure that you adopt the best possible structure for your situation.

4. **Consider Alternative Funding Structures**

If you aim to transfer the business to family members or employees, they may not have the funds readily available to make the purchase or be in a position to obtain bank finance for the full purchase price. Even with third-party buyers, you may be able to achieve a superior result by providing additional vendor finance or structuring the purchase over time. A wide range of legal funding options is available, including secured vendor finance, issue of different classes of shares, staged buyouts, and more. Where significant legal risk is involved, it is critical that your arrangement is correctly documented by a legal expert. You will also need professional advice to decide whether a simple sale for cash or an alternative funding structure can deliver a superior result for you or fit better within your plans.

5. **There's More to Selling a Business than Purchase Price**

It's common for a business owner who's selling their business to become distracted by an attractive initial purchase price. They can fail to properly consider related and critical legal issues including warranty risk, earn-outs, retentions, and restraints of trade. In many instances, a seller may be better off taking a slightly lower price but with drastically reduced warranty risk and little or no earn-out requirements. Effectively, it may be better to take a 'bird in the hand' instead of chasing 'two in the bush'. Agreeing to a high initial purchase price with an earn-out figure that would require the business to have a good year or even outperform its own historical best years could be a disastrous outcome.

6. **Document the Deal Properly**

Even if you are transferring the business to people you know and trust and who know and trust you, it's important to properly document the transaction in its entirety and then undertake the transaction in accordance with those documents. When handled by a legal professional, this process provides clarity and protection for all parties, both during the negotiation and drafting of the transaction documentation stages.

7. **Work with a Specialised Team of Advisors**

Well-performed business succession requires a holistic approach and due consideration of all the relevant issues: financial planning, accounting and business advice, and legal services. This is why we advocate working with a team of advisors who are experienced and accustomed to collaborative advice that's focused on your best interests. There are significant benefits to be gained from working with your professional team to properly understand your current legal circumstances, tax position, and financial and life goals. The most appropriate strategy may then be developed and implemented to achieve a smooth and cost-effective business succession process.

Ensuring a Seamless Transition and Prosperous Future

Effective business succession planning in the mining and resources sector demands a thorough understanding of both internal and external options, along with careful consideration of legal implications and strategic objectives. By preparing well in advance and seeking professional legal advice, business owners can ensure a successful transition and the continued prosperity of their business.

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Planning for the Future: Leveraging Superannuation in Business Succession

As a business owner in the mining and resources sector, you've worked tirelessly to build an enterprise that supports your family and provides for your employees. But what happens when it's time to step back?

While growing your business, retirement planning might not have always been at the forefront of your mind. However, as you start thinking about the future, the structure of your business can significantly impact your finances long after the business is sold.

Succession planning isn't just about finding the right person to take over; it's about ensuring that the structure of your business allows you to maximise the financial rewards you've earned. One of the most effective ways to do this is through strategic superannuation contributions, especially when preparing for the sale of your business.

Business Owners: Start Planning Early for Maximum Benefit

For business owners building an asset they eventually plan to sell, considering your business structure early on is crucial. The earlier you address your structure, the easier and less costly it is to adjust if necessary. By planning ahead, you position yourself to take full advantage of tax-efficient strategies, such as superannuation contributions, and avoid potential pitfalls that could arise from an inefficient structure. This proactive approach ensures that when the time comes to sell, your financial position is optimised, saving you both time and money.

The Power of the Right Structure

Superannuation is traditionally designed for employees, but with the right advice, business owners can use their business assets to significantly boost their superannuation savings. The key lies in having the optimal business structure in place. This structure not only allows for more efficient tax management but also positions you to take full advantage of superannuation contributions—both concessional and non-concessional.

Boosting Super with Business Sale Proceeds

When you sell your business, there are two significant Capital Gains Tax (CGT) exemptions available that can enhance your superannuation.

1. **Small Business 15-Year Exemption:** If you've owned a business asset for at least 15 years and are over 55 years of age, selling the asset can exempt you from CGT if you're retiring or permanently incapacitated. The proceeds from this sale can be contributed to your superannuation as a non-concessional contribution. To maximise this benefit, notify your super fund so the contribution counts toward your CGT cap ($1,780,000 for 2024-25) instead of your non-concessional cap.
2. **Concessional Contributions:** These contributions are tax-effective because they reduce your taxable income. Whether made through your business or personally, these contributions can provide immediate tax relief and long-term benefits by growing your superannuation in a low-tax environment.

In addition to the above, there may be other tax effective business super contribution opportunities which may be available to you, even if you aren't over the age of 55.

Maximising Superannuation Along the Way

Beyond the sale of your business, regular superannuation contributions can help you build a substantial retirement fund over time. By consistently contributing, you take advantage of a tax environment that is often more favourable than other options, such as holding assets in a company, trust, or personal capacity.

- **Tax-Effective Concessional Contributions:** These contributions lower your taxable income, offering a dual benefit of tax savings now and growth in a low-tax environment later.
- **Non-Concessional Contributions:** Though they don't reduce taxable income, these contributions allow you to hold assets in a superannuation fund, where earnings and capital gains are taxed at a maximum of 15%—a significant reduction compared to higher rates in other structures.

The Impact of an Inefficient Business Structure

Overlooking business structure alignment with your long term goals can lead to significant challenges, both financially and operationally:

- **Financial Strain:** An inefficient structure can result in escalating costs, particularly when it comes to tax and stamp duty implications. The longer you wait to make adjustments, the more expensive it can become to sell your business or undertake a business restructure.
- **Missed Opportunities:** Without a structure that supports your succession plans, you might not be eligible for the valuable superannuation benefits designed specifically for small business owners. This could mean more money goes to tax and less is retained in for your own financial security.
- **Succession Hurdles:** An unsuitable structure can create obstacles in passing your business to the next generation. For example, a family trust that doesn't allow for ownership transition, or a complex setup with intricate tax issues, can make succession costly and challenging. Addressing these issues early can save you from significant complications down the road and instead have your business succession ready.

Next Steps: Prepare for a Better Future

If you're planning to build a business worth selling, now is the time to seek professional advice. Ensuring you have the right business structure in place will not only facilitate a smooth transition but also allow you to capitalise on the tax concessions available, particularly through superannuation contributions. Start planning today to secure a better financial future tomorrow.

For more information, please contact James Marshall for a 20-minute, no-obligation discussion. You can call James at +61 (0) 7 3007 2000 or email contact@resourcesunearthed.com.au.

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Contact

At Resources Unearthed, our family office services and intergenerational wealth management and transfer advice is customised to the needs of business owners, high net wealth individuals and family groups. For more information and advice about family office services, please contact us:

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