



Business Wealth Extraction and the Post 2009 Federal Budget

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Financial Security should be the primary objective to a successful exit in the event of a Retirement, Illness or Death of any principal of a business or a professional partnership (Enterprise). A statement of the obvious perhaps, but many principals in fact neglect their personal finances.

What follows is an overview of how a principal of an Enterprise can provide for financial security for their Retirement or for their families an event of Illness or Death, and the implications for principals of Enterprise, following the Federal Budget of 2009.

Succession Planning and Personal Financial Planning

Even very basic personal financial planning involves a bewildering array of increasingly sophisticated strategies and services.

For principals, the choices are especially complex, and few are willing or able to devote enough time to planning their financial future correctly to meet their own particular circumstances. Also, principals who own successful Enterprises often tend to believe that the business or professional practice itself represents their personal nest-egg; that it will, in some unspecified way, guarantee them financial security when the time comes for them to step down in retirement or in the event of

death or illness could provide for their family's needs. This may well accidentally turn out to be true, but it involves a number of assumptions that cannot always be taken for granted.

Sometimes the way ahead is clear and uncomplicated. If the principal has enough money invested outside the Enterprise to provide for a secure retirement, and has planned for management succession, they may want to pass on their interest in the Enterprise to the next generation. What maybe realised too late is that the Enterprise is not capable of either producing sufficient income post retirement of the principal or never was capable of producing sufficient income without the involvement of the principal.

On the other hand, there may be no suitable successor, or it may be felt that family relationships are likely to improve if the Enterprise is sold. Perhaps the principal has simply had enough of the Enterprise and would like to take on a new challenge. The answer in such circumstances may well be to sell the Enterprise. However this assumes that the Enterprise is capable of being sold for value and that the Enterprise has been prepared for sale.

Unfortunately in many circumstances principals fail to plan for their exit either for retirement, illness or



death and as such the Enterprise is liquidated at fire sale values.

Building Financial Security for principals of Business or Professional Partnership

The financial situation of principals who continue to own the Enterprise after Retirement is likely to alter abruptly. As well as an end to in-service benefits, the amount of money such principals can draw from their Enterprise will be limited by the capacity of the Enterprise to pay an income to both the principal and the successor as manager of the Enterprise, and by rules that limit tax deductibility.

Also, if most of the principal's assets are tied up in the Enterprise (as is often the case), Retirement or dependant income on Death or Illness, income will become dependent on the ability of the next generation to manage the Enterprise successfully. This may not be a problem, but some principals are actually forced out of Retirement to take over from incompetent successors in order to protect their own financial security.

Wealth In Or Out Of The Business Or Professional Partnership

Financial peace of mind is a crucial ingredient in a successful retirement but there are two schools of thought on the best way for principals to engineer their own security. Broadly, a principal can either operate a policy of continuously extracting wealth out of the Enterprise during their period of tenure, or a principal can leave wealth in the balance sheet of the Enterprise so that it builds up to the point when, on Retirement or Death or Illness, a restructure is arranged in order to transfer personal

wealth to the departing principal or the estate.

A program of wealth extraction from the Enterprise (to fund superannuation or other investments, savings schemes and so forth) may, in the long term, represent a significant drain on the Enterprise resources. On occasions it can seriously weaken the Enterprise finances. Building up the balance sheet instead, however, exposes the principal to the risk that if the Enterprise suffers financial troubles at some stage in the future, the effects will spill over into their personal financial affairs.

The 2009 Federal Budget Changes to Enterprise Wealth Extraction

Wealth extraction on a timed basis will need to be reconsidered following the Federal Government 2009 Budget proposal to reduce the superannuation concessional contributions cap from \$50,000 to \$25,000. This cap will be indexed.

The existing transitional cap for concessional contributions for those aged 50 years and over will also be reduced, from \$100,000 to \$50,000. This reduced cap will apply for the 2009-10, 2010-11 and 2011-12 financial years, after which affected persons will revert to the lower \$25,000 cap (or applicable indexed amount). The transitional cap is not indexed.

The non-concessional contributions cap will remain at \$150,000 for the 2009-10 financial year, and will only increase when the new lower \$25,000 cap is increased by indexation.

Given the above changes wealth extraction from the Enterprise to superannuation will need to



be revised significantly through careful long term planning.

The Way Forward

There are no obvious right or wrong solutions here. Much will depend on the individual circumstances, in particular the cash flow, type of Enterprise and general resilience of the Enterprise concerned.

If the Enterprise can accommodate a long-term cash withdrawal program, then from the principal's point of view it offers important advantages:

- It protects the principal's personal wealth against Enterprise failure;
- It enables the principal to spread their assets away from the Enterprise, freeing money for investment in a balanced and diversified portfolio; and
- The principal can maximise investment returns by switching between asset classes and markets when opportunities arise.

There are a variety of strategies that represent a middle course between the extremes of continuous cash withdrawal and building the

balance sheet that can be employed to provide financial security for the principal before they relinquish control. Possibilities include, for example, the business redeeming capital, partial liquidations, and the sale of interests to children working in the business at market or less than market value.

Furthermore consideration could be long term regular superannuation contributions for principals or transferring business real property to superannuation through an approved borrowing programme in line with superannuation legislation.

To find out more about ili courses and workshops in respect to Business Wealth Extraction especially post the Federal Budget 2009 in respect to Succession, Retirement, Illness and Estate Planning please visit our website www.ili.com.au.

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