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Let’s chat

Pre-business sale considerations – Minimsing tax risks – March 2025

With:
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Information provided is general in nature; precise application depends on specific circumstances

Overview

- Context:
  - Client: calls you in relation to an enticing offer to sell their business
  - You: …
- Based on a paper written by a tax Colleague
- Presentation intended to assist in identifying what issues may come up
- Giving an opportunity to prepare and manage such risks with sufficient time to boot

To sell the business or shares?

- Type of sales:
  - **Entity Sale:** Sale of ownership interests (units or shares) in an entity, known as the "target entity".
  - **Asset Sale:** Sale of business assets while the original business entity is retained by the vendors.
  - **Hybrid Sale:** Combination of both entity and asset sale (less common).
- The 101 difference:
  - Entity Sale: Potential acquisition of historic risks associated with the entity.
  - Asset Sale: Potentially simpler transaction but may trap capital gains or trigger stamp duty liabilities.

To sell the business or shares?

- Asset sales may be more common for small businesses due to the perception that risk exists acquiring a small business entity (due to less sophisticated systems)
- Some circumstances where entity sales are undertaken for small businesses:
  - May be requested by larger businesses/private capital firms.
  - Requires the small business entity to 'clean up' prior to the sell.

Caveat emptor (*buyer beware*)

- ***Employment related issues***
  - Asset sales – employment contracts generally terminated in the old entity and re-employed by the purchaser
  - Asset sales – historical employment risk mitigated, but potential cost in relation to 'paying out annual and long-service leave'
  - Negotiating tactic – left with the lawyers and parties to haggle

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- ***Payroll tax***
  - Query whether financials show appropriate payroll tax liability being budgeted (particularly where wages are close to the threshold)
  - Ensuring understanding of where employees located, where entity registered and whether there is a broader payroll tax group
  - Lack of registration may result in indefinite review period (compared to a general 5 year review period)
  - Consider significant contractor payments, particularly where they perform a core function of the business:
    - Will require an understanding of the contractor agreement and their purpose within the business
    - Consideration whether exemptions apply.
  - Consider the application of the employment agent provisions
  - Consider the application of payroll tax grouping and whether a seller is required to obtain a 'grouping exclusion order'

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- ***PAYG***
  - Consider whether PAYG obligations met, including:
    - Payments to directors
    - Return to work payments
    - Payments under labour hire arrangements
    - Compensation payments
    - Unused leave payments
  - Failure for a selling entity to comply with obligations increases the risk of a purchaser inheriting an entity with potential penalties applying (once identified) – risk of an incoming director
  - Error may arise due to unsophisticated payment software

Caveat emptor (*buyer beware*)

- ***Superannuation guarantee***
  - Has superannuation been paid to contractors (if required)?
    - Has appreciation been made in relation to the broader definition of employee under the superannuation guarantee legislation
  - Have payments fallen within the definition of ordinary time earnings as required or have they been improperly coded as not being ordinary time earnings
  - Risk of superannuation guarantee charges applying following acquisition
    - Penalties equal to 200% of the superannuation amount plus interest and fixed administrative component
  - Another director risk, as they may be personally liable for unpaid superannuation guarantee charge amounts

Caveat emptor (*buyer beware*)

- ***Fringe benefits tax***
  - Consider benefits to entities or persons related to the employee
  - Consider whether appropriate fringe benefits records exist and if there may be any risk
  - Common issues requiring investigation:
    - Whether any vehicles are privately used by employees
    - Whether car parking is provided to employees

Caveat emptor (*buyer beware*)

- ***Significant cash transactions***
  - Is the target entity operating on a 'physical cash' basis and discounting amounts (perhaps equal to the GST amount that would otherwise be payable)
  - Do the financials make sense – i.e. are there off the book transactions made
- ***Input tax credit refunds***
  - Has the target entity frequently been in a refund position?
  - Fine for some businesses (those which makes GST-free supplies) such as certain medical businesses or gold refineries
- ***Franking credits***
  - Review of franking credit accounts
  - I.e. a purchaser would expect to be able to extract profits from a company (where the purchase acquires the shares) fully franked

Caveat emptor (*buyer beware*)

- ***Family trust elections or interposed entity elections***
  - Acquiring an entity that has made an election may result in family trust distribution tax when extracting profits
  - Risk arises where there have been historical losses, and discretionary trusts may have been involved in the seller's broader group
  - Ensuring appropriate tax warranties confirming whether such elections have been made or not
- ***Cross border transactions and related party loans***
  - Self-explanatory in relation to the increased risk of either ATO audit activity or managing the existing related party loan risk

Caveat emptor (*buyer beware*)

- ***Recent transaction considerations***
  - Additional care required in the event any of the following transactions were undertaken by the target entity:
    - GST increasing adjustments
    - Internal restructures and rollover claims
    - Dutiable asset acquisitions
      - Multiple dutiable transactions that might be aggregated
      - Dealing in jurisdictions where stamp duty knowledge unknown in relation to treatment of assets
    - Corporate reconstruction duty concessions

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Spring cleaning

- ***Pre-sale dividends***
  - Ensuring dividends can be franked
  - Where franking credits available, steps should be taken to ensure that shareholders claiming a franking credit is a 'qualified person'
  - Note the added requirements where a discretionary trust must meet the qualified person threshold:
    - That is, a family trust election is required to be met
  - Further, the related payments rule must be met requiring shareholders to hold the shares 'at risk' for a period of time (45 days for ordinary shares, and 90 days for preference shares).

Spring cleaning

- ***Historical tax risks***
  - Need for tax warranties
  - Distinction between:
    - Definite Tax Liabilities – relating to historic tax issues such as:
      - Where an entity was unknowingly part of a payroll tax group; or
      - Where benefits provided to employees were fringe benefits and subject to fringe benefits tax; or
      - Where contractors should have been treated as employees for the purposes of superannuation guarantee;
    - Potential Tax Liabilities – relating to tax risks resulting from an interpretation of law adopted by the seller, such as:
      - where an employer has adopted a position that benefits provided to employees are not in relation to their employment, and not subject to fringe benefits tax;
      - where an employer has adopted a position that a contractor is a "genuine" contractor and payments to them are not subject to superannuation guarantees or form part of the entity's taxable wages for payroll tax

Spring cleaning

- ***Historical tax risks***
  - Definite Tax Liabilities – voluntary or formal disclosure expected
  - Potential Tax Liabilities – consideration of a private binding ruling where both parties in agreement of position
  - Appropriate warranties manage future risk position

Spring cleaning

- ***Related party loans***
  - Generally should be 'wiped' clean prior to transaction, especially where dealing with an unrelated party
  - Where cash is not available to clean the loan accounts, thought should be had in relation to the tax implications of forgiving related party loans
    - Division 7A
    - Commercial debt forgiveness – will the purchaser be purchasing an entity with a reduced 'tax value' of assets and/or losses
    - Debt equity swaps – resulting in the commercial debt forgiveness rules applying
    - Division stripping and anti-avoidance provisions – see *Merchant v Commissioner of Taxation* [2024] FCA 498

Temporary full expensing

- For asset sales:
  - Adopting a higher value for depreciable assets may result in tax liability for the seller
  - Reasonable basis should be adopted
  - Generally, not arguable for a seller to adopt a nil value to such depreciating assets
- For entity sales
  - More relevant where a tax consolidated group exists

It's a continuous chat

- Advisors should keep clear communications with clients
- The road to a sale can be a challenging process if the affairs of the business are not adequately in order
- Further, tweaks in intentions can result in vastly different approaches – e.g. where a business is to be transferred to a child or related family member
- May result in different approaches in relation to business assets held outside the relevant trading entity
- For example, where business premises is held via a separate entity, or where intellectual property or service entities are within the group

Being practical

- "Tax tail should not wag the dog"
- Ultimately tax risks should be weighed against attractiveness of the deal
- On the other hand, value of purchase price should be weighed against the risk of a seller failing to meet their own tax considerations (i.e. small business capital gains tax concessions)
  - War story

On an unrelated note

- *Revenue Legislation Amendment Bill 2024*
  - *Assented 28 February 2025*

- Amending *Payroll Tax Act 1971*
  - Wages liable for payroll tax do not include wages paid or payable…(m) by a medical practice to a general practitioner (section 14(2))
  - General practitioner means
    - a person registered under the Health Practitioner Regulation National Law to practise in the medical profession in the specialty of general practice;
    - a medical practitioner specified in the Health Insurance (General Medical Services Table) Regulations 2021 (Cwlth), schedule 1, part 1, clause 1.1.3; or
    - a person—
      - who is a prescribed medical practitioner within the meaning of the Health Insurance (General Medical Services Table) Regulations 2021 (Cwlth); and
      - who predominantly provides services of the kind ordinarily provided by a general practitioner mentioned in paragraph (a).
    - Medical practice means an entity, other than a hospital, carrying on a business at which services of the kind ordinarily provided by a person mentioned in the definition general practitioner, paragraph (a) are provided, whether or not the services are provided from particular premises.

On an unrelated note

- Is this good policy?
- Exemption only available for 'GPs'
- Does not affect any other medical field
- Other practitioners need to consider QRO public ruling (now version 4)
- Key question often comes down to whether a medical practitioner is providing services to a medical centre's patients (on behalf of the medical centre)
- Need for a good contract

Contact details

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