

FARM BUSINESS FACT SHEET

FARM BUSINESS STRUCTURES

Business structure: things you should know and questions to ask your adviser



PHOTO: GRDC

One trigger point for changing business structures is the purchase of new assets

BUSINESS STRUCTURES – BE INFORMED

Farming families rarely change or adopt new business structures without receiving advice from their accountant, farm adviser or lawyer. While the provision of advice on matters within their areas of expertise is the role of advisers, there is an obligation on those receiving the advice to carefully consider the advice received and use the information received to make decisions.

As a lawyer, it is not uncommon to hear that a particular business structure was adopted because an adviser suggested it and that the business is now too complicated or it caused unintended consequences. However, these sentiments tend to indicate that

the stakeholder may have been over-reliant on the adviser and perhaps not enough attention had been paid to the decision making process.

Informed decision-making comes from being able to ask the right questions at the right time, as opposed to making decisions instinctively or simply because an adviser suggested it. This is not to gloss over the responsibility of professional advisers to ensure their clients make good decisions, but rather it highlights the shared obligations of both the adviser and the stakeholders to gather as much relevant information as possible and apply it within the circumstances particular to the stakeholders.

So how do we know what questions to

ask? In part, this comes from having an understanding of a proposed business structure and then making further investigation into how this structure interacts with the important goals and objectives of the family members.

TRIGGER POINTS FOR CHANGING BUSINESS STRUCTURES

Changes to existing business structures are typically triggered by the occurrence of specific events such as:

- the growth of the farm business and a need to better manage tax liabilities;
- the purchase or acquisition of assets;
- planning for or undertaking farm succession; or
- the death or loss in capacity of a stakeholder in the farming business.



These events take place at different stages in the life of a family business and of the stakeholders themselves. Therefore, the process of decision making is complicated by the need to consider and balance the shifting priorities at different times of the stakeholders.

For example, where a block of farming land is being purchased:

- Parents may receive advice from their financial planner that given their concerns in regards to having guaranteed retirement funding, they should consider purchasing the block in a self-managed superannuation fund so the farm business can pay rent as an income stream to the fund; and
- At the same time, their on-farm adult son is receiving contrary advice from the farm adviser, who says the purchase should be in a discretionary trust to facilitate future farm succession and to avoid the land in the super fund being unavailable for use as security for future borrowings.

Notwithstanding that stakeholders may have different concerns and objectives; there is a need for a general level of understanding of how any chosen business structure will interact with the stakeholders' interests and to consider matters that should be addressed in respect of two common farming business structures – the family trust and the partnership.

DISCRETIONARY FAMILY TRUSTS

Using the above example, it is not uncommon for the extent of a buyer's involvement in the decision-making process of whether to buy land in a trust to be limited to signing the trust deed where the lawyer has helpfully placed the 'sign here' stickers and to thereafter consign the copies of the deed to the accountant's permanent file.

However, given the provisions of this trust deed will govern how this farming land is held by the next three family generations and that the deed may be a generic document purchased from an internet supplier for as little as \$80, it seems prudent to carefully consider if:

- a trust is the best structure by which to hold the particular asset and if so; or
- whether provisions of the deed cater for your family's particular circumstances?

To make an informed judgement on these considerations, stakeholders need to ensure they have access to all the necessary information.

TRUSTS – ESSENTIAL CONSIDERATIONS AND QUESTIONS

- Most trust deeds can have a maximum life of 80 years ("vesting date") unless wound up by the trustee on an earlier date. It is prudent to ask your relevant advisers to explain:
 - What are the tax (i.e. capital gains tax and stamp duty)

consequences for the trust and beneficiaries when the Trust is wound up and assets transferred; and

- are the stamp duty consequences different if the land is mortgaged?

A thorough understanding of the potential financial consequences of holding an asset in a separate legal entity will assist in making an informed choice as to whether this is the preferred option over personal ownership.

- It is critical to enquire what the vesting date is and what the trust deed provides for in regards to the distribution of trust assets on this date if the trustee fails to make a prior determination?

One may ask why a trustee would fail to make a determination before the vesting date and the simple answer is that many stakeholders/trustees do not know what date this will occur. Given many existing trusts are now approaching their vesting date (noting many deeds nominate a date less than the maximum 80 years allowed), we have seen several situations where off-farm siblings have inadvertently received an unexpected windfall from a family trust, being a share in farmland.

- It is important to consider that trust deeds from different suppliers are not identical and assumptions



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should not be made that any new trust will have the same provisions as your existing trust deed.

For example, most trust deeds provide that the trust is governed by the offices of an appointor, guardian and trustee. Other deeds provide only for the offices of an appointor and trustee, while some have only a trustee.

Depending on offices provided for in a trust deed, it is important to determine what specific powers are attributed to each role and to not make assumptions.

An example of a common misconception is that it is still common to hear when asking who controls a trust, the response “I am the trustee”.

However, many deeds provide that the trustee holds its office at the absolute discretion of the appointor and in practical terms, this means it is the appointor who controls the trust, with the trustee being a mere puppet.

- It is important to clarify what provisions are made in the trust deed to resolve disputes or deadlocks between, for example, joint appointors.

In this respect, it is noted that trust deeds can be rewritten to suit your preferred method of dispute resolution, whether this be that all decisions must be unanimous, by majority or referred to a third party for mediation and/or arbitration.

- It is critical to understand what

provisions are made in the event of the death and/or legal incapacity of a person who holds any of the roles of trustee, appointor or guardian and if succession of these roles is guaranteed to pass to the appropriate persons.

Similarly important is to clarify what are the valid methods to nominate a successor and what are the disadvantages or advantages of utilising each method (i.e. if I use succession by my will, can this be challenged under estate legislation?).

- Before agreeing to become a trustee, it is important to understand the potential risks of doing so, including being held personally liable for trust liabilities. **It is important to determine who is the most appropriate person or entity to assume the role of trustee after considering the following questions.**

- Does a potential/existing trustee have assets in their own name and if so, is it appropriate that this person expose themselves to liability for farm debt;
- If not then what are the alternative nominees (if any) as trustee (i.e. corporate trustee);
- Are there better options by which to involve children in the farming enterprise than an appointment as trustee (i.e. employment contracts, appointment as appointor in a trust)?

- Given the interrelated nature of business

structures such as trusts and personal estates, when contemplating estate planning a testator (a person who makes a valid will) should specifically enquire with their adviser as to the effect of trust beneficiary loan balances on their testamentary intentions and whether specific consideration needs to be given to dealing with these balances (i.e. forgiveness).

Not carefully considering the impact of loan balances can result in:

- trust assets intended to pass into the control of on-farm children, being paid to the estate in satisfaction of monies owed by the trust to a deceased person; or
- estate assets intended to benefit off-farm children passing from the estate to a farming trust in order to repay monies owed to that trust by a deceased person.

PARTNERSHIPS

When considering entering into a partnership, it is appropriate for a prospective partner to seek independent advice as to the merits of partnership. It is also appropriate for all partners to regularly review and, if necessary, update the agreed provisions in respect of how the partnership is managed.

CONSEQUENCES OF PARTNERSHIP – ESSENTIAL CONSIDERATIONS AND QUESTIONS

- Partners have joint and severable liability for partnership debts and this is contrary to a common misconception that partners are only liable for debts in accordance with their equity in the partnership.

Creditors are entitled to pursue any partner for all of the partnership debt and this means that careful consideration should be given to whether on-farm children or their spouses, or indeed any partner should be introduced into a partnership in their personal capacity thus placing personal assets at risk.

This consideration often involves the weighing up with professional advisers of:

- the advantages offered by partnership, as opposed to the potential liability risks; and
 - whether there are better alternatives to becoming a partner in one's personal capacity (i.e. use of a family trust as a partner)?
- As with trusts and personal estates, a testator should specifically enquire with their adviser as to the effect of partnership equity balances on their estate and whether specific consideration needs to be given to dealing with these balances.

- Existing and prospective partners should discuss with their advisers the advantages of having a formal written partnership agreement and in particular, seek clarification as to what are the legislative provisions that govern the actions of partners in order to avoid inadvertently breaching their respective State's legislation (i.e. expelling a partner when the partnership legislation provides that this cannot happen without an express provision in a deed of partnership).

As part of any discussion regarding the management of partnerships, advice should be sought to ensure adequate provisions are in place to:

- clarify the obligations and contributions expected of each partner;
- authorise the extent to which partners can contract with third parties and incur a liability on behalf of the partnership (i.e. is there specific dollar figure that it is agreed that a partner may incur as a liability of the partnership without the agreement of all partners); and
- determine and set out the process by which a partner can exit the partnership or by which the partnership is otherwise wound up, while ensuring all partners receive fair value for their partnership equity?

SUMMARY

While the role of the advisers is to provide stakeholders with information specific to their respective area of expertise. They do not ultimately make the decisions.

It is ultimately the stakeholders themselves who have a responsibility to ensure that they have the information necessary to make informed judgements about the suitability of a business structure for their personal circumstances.

As part of this process, there is also a responsibility for stakeholders to ensure that any family member contemplating involvement in an existing family business is similarly armed with the requisite knowledge to make good and informed judgements about their involvement. If all family members take on this responsibility then a sound foundation for long-term business success and harmony between family members will be laid.

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Small Business Development Corporation

<https://www.smallbusiness.wa.gov.au>

Department of Industry Innovation and Science

<https://www.business.gov.au>

Australian Securities and Investment Commission website:

<http://asic.gov.au/for-business/your-business/your-business-structure>

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