

# FARM BUSINESS FACT SHEET

Young grower Jock McNeil has big plans for his family's cropping farm.



PHOTO: REBECCA JENNINGS

## Key points

- Business structures which enable financial independence between generations provide financial security for the parents in retirement while preparing the next generation with the ability to take on new business opportunities.
- The business structure can be adjusted or transitioned as each generation moves into or out of the business.

## Structuring your business for generational transfer

### Introduction

Many options available to farming businesses to facilitate generational transfer depend on having appropriate business structures in place. While sound planning, clear communication and careful financial analysis are key success factors in generational transfer, the family's legal business structure and how its particular advantages and disadvantages play out needs to be assessed and understood early in the transfer process to ensure the needs of each generation are met.

**Please note:** *In the context of this Fact Sheet, generational transition, generational transfer and succession planning refer to the same process and the terms can be used interchangeably.*

### The timeline for generational transition

Transfer of land is often the initial focus with succession planning; however, to achieve the best outcome for all involved it is often better if it is the last consideration. Generational transition should firstly focus on the people and their role in the business and the opportunity for them to be rewarded for their efforts.

The transition between generations is a journey with distinct phases. This total journey can take up to 25 years. The timelines are determined by the choices and preferences of the people involved, both the older and younger generations.

As a suggestion, the journey of transition can progress within the following timelines, starting from when the next generation returns to the business:

- two to six years – Transition of management/responsibility
- three to 10 years – Transition of income/costs/profits
- 10 to 25 years – Transition of existing assets\*

\*New asset purchases can be made by the next generation at any point in the timeline.

Irrespective of the timelines that are required for individual circumstances, there needs to be a clear and well-communicated plan that is followed to ensure all are informed about and comfortable with the timelines and process, including off-farm family members.

This Fact Sheet explores the important role business structures can play in the transition process, particularly where

generations farm together, sharing the use of assets and profits to their individual family's benefit and futures.

The existence or development of an appropriate and flexible business structure provides the means to implement the transition in a transparent, equitable and effective way.

## Choosing the right structure

There are four broad options for legal ownership and trading.

1. Sole trader.
2. Partnership.
3. Family trust.
4. Company.

Please refer to the GRDC Fact Sheet on 'Farm Business Structures' for a more detailed explanation of each structure (<https://grdc.com.au/resources-and-publications/all-publications/factsheets/2016/10/business-structures-explained>).

It is important to be clear how, and for all to understand how, land assets and other assets are owned and how profits from the business are distributed. Ask yourself:

- What entity operates the farm business?
- What entity owns the land?
- How is income distributed?
- What would unfold should a key person die?

It is critically important that business owners also have a detailed understanding of how the business structure they operate works from a control, liability and succession point of view.

When considering which structure to use it is important to consider the amount of debt carried by the business and how it is managed. Prematurely transferring debt to the next generation can be problematic if not associated with asset transfer. The shifting of debt to the next generation needs to be considered closely (that is, whether the debt will inhibit the management and viability of the business). Taking on risk without getting a proportionate level of control is not a normal commercial action.

## BUSINESS STRUCTURES FOR GENERATIONS FARMING TOGETHER AND PROFIT SHARING

Sharing of income/costs and subsequent profits is suggested to commence once the next generation has settled in and made a commitment to the farming business as their career. It typically occurs three to 10 years after their return to the farm business.

The most appropriate business structure during this transition period will be determined by the needs of each generation and will include consideration of factors such as:

- need for financial independence;
- flexibility of profit allocation; and
- goals and attitudes towards investing off-farm versus on-farm growth.

## CASE STUDIES

Possible options for profit allocation are illustrated by case studies 1, 2 and 3 (Figures 1, 2 and 3, respectively). The case studies demonstrate the flexibility of a Discretionary Family Trust and how it can be used alongside other business structures to provide effective ways of distributing profit to individuals while families are working together during generational transition.

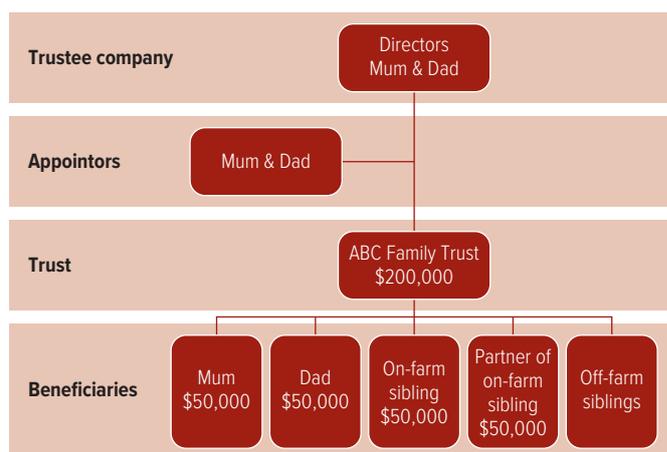
In each case study the assumption is that the business trades as a Discretionary Family Trust and the business profit is \$200,000.

**Please note:** *The following case studies illustrate structure options for a business (trading) entity (i.e. profit allocation) and are NOT referring to structure options for the holding of fixed assets such as land.*

### Case study 1

Multiple family members receive a trust distribution as beneficiaries of the existing ABC Family Trust (Figure 1).

**FIGURE 1 ABC Family Trust distributions are made to multiple family members.**



Case study 1 offers the following **advantages** and **disadvantages**.

- **Advantages:**
  - Easy to establish.
  - Flexible profit allocation.
- **Disadvantages:**
  - Trust is controlled by the trustees (usually the parents), therefore members of the next generation have no ownership until the parents transfer their roles in the trust.
  - Next generation have no financial independence either for personal/lifestyle choices or their own business growth.

### Case study 2

Both the next generation on-farm family and Mum and Dad receive a trust distribution to their own entity (Next Generation Trust and Mum & Dad Trust, respectively) as a beneficiary of the existing ABC Family Trust (Figure 2).

Case study 2 offers the following **advantages** and **disadvantages**.

- **Advantages:**
  - Flexible profit allocation.
  - Individuals can utilise their profit allocation to invest in assets either on-farm or off-farm for their individual benefit and with clear, separate ownership.
  - Enables the older generation to allocate profits to non-farm investments that can assist with their financial independence and with future estate planning.
- **Disadvantages:**
  - Additional compliance costs from the multiple entities.

### Case study 3

The next generation start a new business entity alongside but separate to the existing ABC Family Trust. This new entity can farm by leasing or buying new additional land and utilising the machinery of the existing family trust (Figure 3). Case study 3 offers the following **advantages** and **disadvantages**.

#### Advantages:

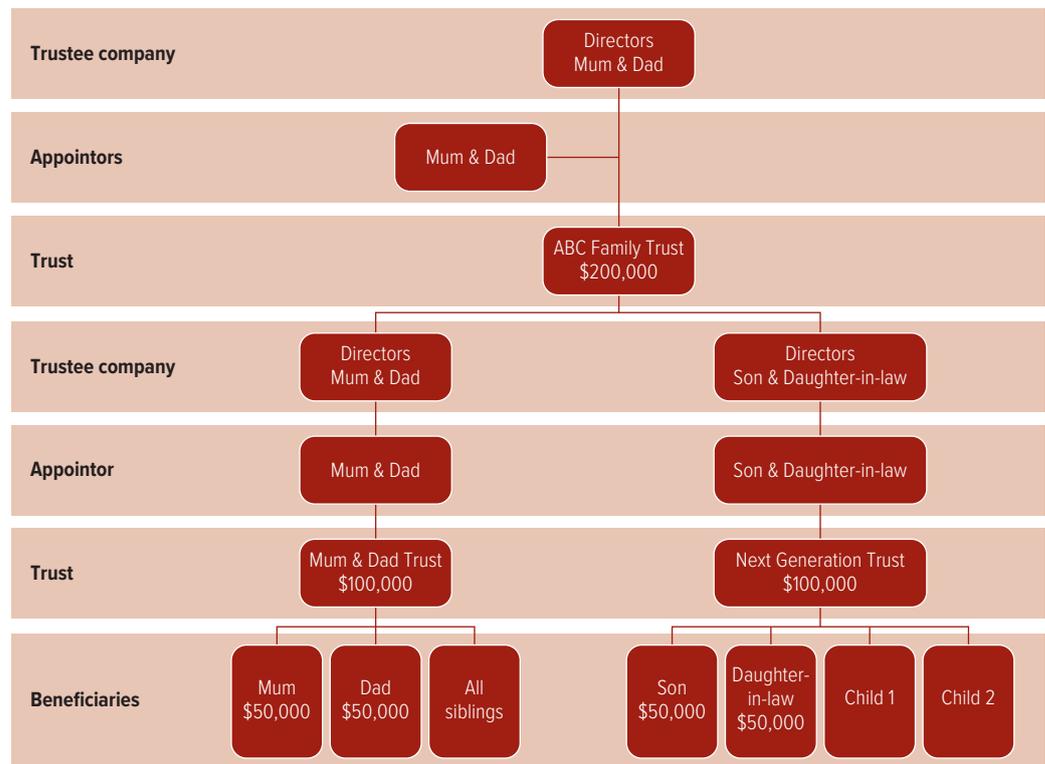
- The next generation:
  - Develop skills in business management including buying, selling and compliance.
  - Have an opportunity to develop a 'track record' with demonstrated business performance (credit rating) to support future land or machinery purchases.
  - Can gradually purchase and upgrade machinery into the next generations' entity.
  - Can increase eligibility for government support/ exceptional circumstances, etc.

- The older generations' business assets can be less exposed to future risks.

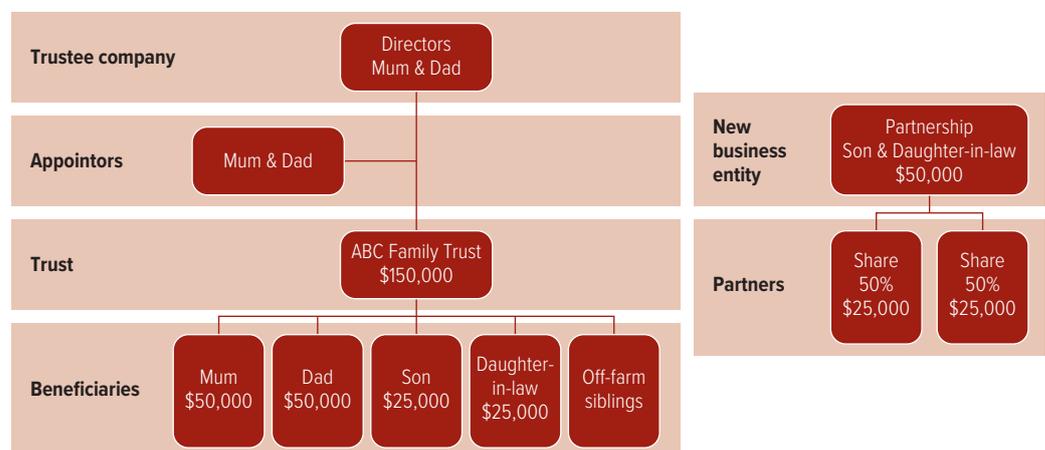
#### Disadvantages:

- Additional compliance costs from two separate trading entities.
- Can cause concerns with regards to whose paddocks are to be prioritised for cropping first.

**FIGURE 2** ABC Family Trust distributions are made to separate trusts for each of the generations/business partners.



**FIGURE 3** New business entity ('Next generation (Son & Daughter-in-law) Partnership') is started alongside the existing ABC Family Trust. Next generation remain beneficiaries of existing ABC Family Trust and therefore can receive profit distribution.



The case studies above are a sample of several options for consideration. They are intended to demonstrate the important role business structures can play in facilitating generational transfer. It is recommended to seek advice from your accountant or legal adviser to discuss your personal situation.

## Farm land transfers and duty exemptions in Western Australia

After transition of the business entity, the final stage is the generational transfer of the main asset, the farming land.

Within Western Australia, access to the exemption from

transfer duty of farming land between family members is dependent on the transferor's farming and landholding structures and the transferee's proposed structure being compliant with the requirements of the *Duties Act WA 2008*.

For the purposes of the farmland transfer exemption, the Duties Act defines 'family members' of a transferor as being their children and grandchildren, their parents, their brothers and sisters and the children of these parties (all in the bloodline, not on the spouse's side), aunts and uncles, and current and former spouses and de facto partners of at least two years.

In some circumstances, in order to qualify for the exemption it may be necessary to consider restructuring existing landholding

and business structures in advance of anticipated farmland transfers, particularly given that farmland cannot be transferred duty-exempt directly from a family trust (i.e. must be vested first) and the transferor must always be farming the parcel of farming land to be transferred immediately prior to the date of transfer (i.e. earning primary production income from that parcel of land).

Regarding the requirement to be farming a parcel of land immediately prior to a transfer, the transferor can farm it personally, in partnership (if all other partners are family members), through a trust (if all beneficiaries are family members) or through a company or unit trust of which every other shareholder or unit holder is a family member.

If the transferee (i.e. next generation) intends to own the land in a trust then the only available structuring alternatives are:

- the landowning trust must then farm the land itself; or
- the land can be farmed by another trust, of which the landowning trust is a beneficiary (note no other trust beneficiaries can be companies or trusts); or
- the land is farmed by a partnership comprised of the landowning trust and 'family members' of the transferor of the land.

**In summary:**

- A brother (referred to as Brother 1) can transfer land to his brother (referred to as Brother 2) and/or Brother 2's wife or de facto partner (of at least two years) fully duty exempt.
- However, land owned by Brother 1 and his wife or de facto cannot be transferred to Brother 2 and/or Brother 2's wife fully exempt from duty. The reason being that Brother 1's wife/ de facto is not defined in the Duty Act as a family member of Brother 2 (duty is payable on the transfer of the interest of Brother 1's wife/de facto).
- A mother and father can transfer to their son and/or daughter and spouse/de facto of these parties fully duty exempt.
- Land farmed by a partnership of individuals and a trust after the transfer of land will not qualify for duty exemption if the trust has any non 'family member' beneficiaries.
- The transfer of land that takes place after a grower has retired from farming does not qualify for the exemption. It is therefore important that the transferee does not take over the farming business before the land transfer is documented.
- Share farming and/or leasing of land by the transferor prior to the transfer is not considered to be 'in the business of primary production' and will not qualify for the exemption.
- It is not allowable for the transferor to continue being involved in the farming business after the land has been transferred.
- Cousins are not deemed to be 'family members'.

Given the technical requirements of accessing the exemption, forward planning and input from your advisers will assist in ensuring the transition of land occurs in a sound, cost-effective manner.

## Conclusion

Ensuring that there is a good understanding of business structures and how they interact and operate as the business is transitioned is a vital key step to ensure successful and positive generational transfer.

By understanding your business's structures, you can make informed and flexible decisions which provide the opportunity to not only leave a viable legacy for the next generation but for that next generation to have a similar opportunity to leave its own legacy.

## FREQUENTLY ASKED QUESTIONS

### When is the best time to review your business structure?

Changing business structure is a decision that should not be taken lightly as it can have many implications and consequences. The suitability and flexibility of the current business structure should come under regular scrutiny when discussions begin about the future needs of the old and new generations and when changes to profit allocation can be beneficial to progress the transition.

## USEFUL RESOURCES

**GRDC Fact Sheet Farm Business Structures:** <https://grdc.com.au/resources-and-publications/all-publications/factsheets/2016/10/business-structures-explained>

**Pacer Legal:** [www.pacerlegal.com.au](http://www.pacerlegal.com.au)

**Farm Business Models GrowNotes:** <https://grdc.com.au/grownotes-farm-business-models>

## MORE INFORMATION

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## GRDC RESEARCH CODE

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