THE BUSINESS SUCCESSION AGREEMENT

Need for a Legal Agreement

It is not possible to structure an effective Buy/Sell or Equity Insurance arrangement without a legal agreement between the Proprietors about maintenance of the Insurance Policies and the consequences of Death, Disablement or Traumatisation of a Proprietor.

Purpose of Legal Agreement

The purpose of the Agreement is to provide a mechanism for the ***orderly transition of ownership in the event of Death, Disablement or Traumatisation***.

The Agreement provides for:

(a) the ***establishment*** of the Policies;

(b) the ***maintenance*** of the Policies;

(c) the determination of the ***Sum Insured***;

(d) the ***funding of Premiums*** (including the apportionment of liability for the Premiums between the Proprietors);

(e) the ***obligation of the Outgoing Proprietor (and any Related Parties) to sell their Equity***;

(f) the ***obligation of the Continuing Proprietors (and any Related Parties) to buy the Outgoing Proprietor's Equity***;

(g) the determination of the ***Purchase Price***;

(h) the collection of the ***Proceeds of the Policy*** upon the occurrence of an Insured Event;

(i) the ***distribution of the Insurance Proceeds;***

(j) the ***purchase of the Equity*** by the Continuing Proprietors (and any Related Parties);

(k) the ***transfer of the Equity by the Outgoing Proprietor (and any Related Parties) to the Continuing Proprietors (and any Related Parties)***;

(l) the admission of ***new Proprietors***;

(m) a mechanism for ***resolving disputes***; and

(n) the ***termination of the Agreement***.

SUMMARY OF BUSINESS SUCCESSION AGREEMENT

The effect of the Agreement may be summarised as follows:

(a) The Proprietors of the Business arrange for ***Insurance Policies*** to be taken out on the life of each Proprietor (***clause 3***);

(b) Each Policy is held by the Policy Owner specified in the Schedule (usually the ***Proprietor*** or ***Life Insured)*** (***clause 2***);

(c) An ***Outgoing Proprietor's Equity*** is defined to ***include any Equity held by a Related Party*** that must be sold upon the occurrence of an Insured Event with respect to the Proprietor (***clause 1.1);***

(d) The amount of the Sum Insured attributable to the ***Purchase Price*** under each Policy will be the ***value of the Outgoing Proprietor's Equity***;

(e) The parties can also include ***Personal Cover*** on their Policy in addition to their Buy/Sell Cover;

(f) The ***responsibility for payment of the Premiums*** is set out in the Schedule. In most cases, the Proprietors will pay a share of the total cost of the Premiums on the Policies proportionate to their Equity in the Business (clause 6, Schedule). Each Proprietor will be responsible for payment of the Premium for their own Personal Cover;

(g) The ***creation of any contract of sale*** under the agreement is ***subject to the deemed creation of a contract (or the exercise of an option)*** upon the occurrence of the ***following conditions precedent***:

 (i) The Outgoing Proprietor dies or suffers an Insured Event;

 (ii) The Outgoing Proprietor is survived by one or more Continuing Proprietors;

 (iii) The Insurer pays the Net Proceeds of the Policy on the life of the Outgoing Proprietor to the Trustee; and

 (iv) The Net Proceeds of the Policy are not less than the amount of the Purchase Price of the Outgoing Proprietor's Equity that the parties have agreed to insure (***clause 10.1***);

(h) Only once these conditions precedent have occurred (or the option has been exercised), is there ***deemed to be a contract of sale*** pursuant to which:

 (i) the Outgoing Proprietor (or the Executor of their Estate) and any Related Parties must ***sell the Outgoing Proprietor's Equity*** to the Continuing Proprietors and any Related Parties; and

 (ii) the Continuing Proprietors and any Related Parties must ***purchase the Outgoing Proprietor's Equity*** (***clause 10.3***);

(i) Once these conditions precedent have been satisfied (or the option has been exercised), the ***Policy Owner (usually the Outgoing Proprietor or the Executor of their Estate) will collect the net Proceeds of the Policy attributable to the Purchase Price and the Personal Cover***

(***clause 9.1***);

(j) The ***payment of the net Proceeds of the Policy attributable to the Purchase Price reduces the amount of the Purchase Price otherwise payable by the Purchasers for the Outgoing Proprietor's Equity*** (***clause 14.3***). Any shortfall is payable in accordance with ***clause 14.1(b)*** or any Vendor Finance Provisions in the Schedules;

(k) As ***new Proprietors*** acquire an interest in the Business, they become parties to the Agreement. However, for capital gains tax reasons, ***clause 17.3*** expressly prohibits any payment by Incoming Proprietors for their interest in the Agreement or the Policies, notwithstanding that there may be consideration for the acquisition of their interest in the Business itself; and

(l) If a ***Proprietor retires from the Business***, the Policy with respect to the Proprietor remains the property of the Retiring or Outgoing Proprietor. The Outgoing Proprietor's interest in the Policies over the Continuing Proprietors' lives also ceases. There is no consideration for the "assignment" which effects this vesting. This is for capital gains tax reasons.

HOW A SELF-OWNERSHIP BUSINESS SUCCESSION AGREEMENT WORKS

The Need for a "Crediting Provision"

Each Proprietor’s Policy is owned by the Proprietor or Life Insured.

The Insurance Company must pay the Insurance Proceeds attributable to the Purchase Price directly to the Life Insured or their Estate, even before any transfer of the Equity in the Business is supplied to the Purchasers.

This places the Estate in a position of control.

A traditional contract of sale requires an exchange of the Purchase Price for a transfer of the Equity at completion.

Because the Estate will have both the Equity and the cash, the Purchasers are vulnerable, particularly if there is no Business Succession Agreement.

A modern Self-Ownership Agreement doesn't provide for a traditional "exchange".

Instead, it contains a "Crediting Provision" that:

- gives the Purchasers "credit" for the funds paid to the Vendor by the Insurance Company; and
- therefore requires the Vendor to transfer the Equity without any additional payment by the Purchasers.

Deemed Sale Price and Cost Base

Because the Purchasers obtain the benefit of the Insurance Proceeds through the operation of the "Crediting Provision", they will not usually have to pay any Purchase Price for the Equity, unless the Purchase Price exceeds the Insurance Proceeds.

As a result, it could be argued that they will not have a substantive Cost Base for CGT purposes.

This could increase the amount of their Capital Gain in the case of a subsequent sale.

However, the ATO will apply the Market Value Substitution Rules under section 116-30, so that:

- the Purchasers will be deemed to have paid market value for the Equity; and
- the Vendors will be deemed to have received the market value.

Thus, the Purchasers will have a substantive Cost Base, but the Vendors will incur a CGT liability with respect to the sale, as if they had received the market value.