Private Clients

Personal commitment. Professional expertise.

Grow

Edition 10 | 2015

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News flash:

Hurry - Entries close at midnight on Tuesday 13 October

Enter here

PwC's Private Clients has joined up with BRW to launch 'Aspire' a national awards program to recognise the contribution that private and family businesses make to the Australian economy.

The Aspire awards seek out the transformations and initiatives that make private business the unsung hero of Australian prosperity.

It's simple to enter and get your business the national recognition it deserves. Click here to enter as many categories as you like.

Winners will receive coverage in BRW and the Australian Financial Review, and be invited to an awards presentation evening at Sydney's Establishment on Tuesday, November 10.

2015 BRW aspire awards

for business, family and you

pwc BRW PwC's Private Clients

For more information on why we are supporting these awards please click here.

Below is a summary of what each BRW Aspire Award category celebrates:

- Private Business Growth & Transformation: Businesses that have either successfully transformed to grow or adapt to changing environment/demands; or has had sustainable growth over time
- Successful Family Business: Success incorporates sustainable growth, alignment of both business and family values & goals, succession plans, governance, and measures in place to deal with conflict.
- Asian Success: Those organisation building strong business relationships in Asia (importing, exporting, JVs etc)
- Start-up Disruptor: Business trading three years or less, that are innovative or disruptive in their industry/market
- Societal Impact: Strategies or initiatives put in place with an outcome of societal benefit in some form, not just charity donations - innovative ways of giving back to the community
- Innovative Capital Raising: Aimed at VC, angel investors, innovative bank products, as well as unique ways that businesses have raised capital
- PwC's Next Rich Award. Focus on a richer life, health and lifestyle are as important as revenue. Next rich is a new type of currency. Recognising businesses that have put programs in place to improve productivity, staff engagement, reduced staff turnover or other quantifiable measures.

Article 1

Employee share schemes

Employee share schemes article | Grow Edition 10 2015

Start-ups to benefit from tax changes to employee share schemes

In June this year Parliament passed changes to the employee share scheme (ESS) taxation rules. All companies that provide ESS awards post 30 June 2015 will benefit from the amendments, especially start-ups.

The amendments aim to offer further tax concessions to employees and position Australia as an optimal destination for business innovation.

A two-way commitment

Employee share ownership has been shown to promote employee engagement and productivity. Companies who have ESS awards usually have a better connection with their employees, and employees have an enhanced relationship with the business, resulting in higher productivity.

Businesses have struggled under the complexity of the rules, causing a significant drop in overall participation in these schemes. The new rules:

- improve the tax deferral concession for rights awarded to employees
- increase the maximum deferral period for eligible schemes from seven to 15 years
- introduce new taxation concessions for employees of eligible start-ups
- allow employees to obtain a refund of tax if the employee lets their rights lapse, for example because they are 'out of the money', provided the scheme has not been structured to protect the employee from downside market risk
- provide new powers to the Commissioner of Taxation to develop safe harbour valuation methodologies and streamline the process of establishing and maintaining ESS by developing pro forma documentation.

Rights to be taxed at exercise not vesting

The change that will have the greatest impact on all companies is the new rule which taxes deferred rights based schemes at exercise (rather than at vesting). Under this new rule, the previous requirement to access tax deferral being a 'real risk of forfeiture' is no longer necessary.

"This is a huge win for business," says Director Karen Quinsey, PwC's Private Clients Team. "It means that you'll only be taxed at a liquidity event when you have something tangible to be taxed on, making ESS more attractive to both companies and employees."

Further, under the previous rules, tax deferral was only available for employees who have less than 5% ownership and voting rights in the company. The new rules have relaxed this condition by doubling the existing limit to 10%.

50%

discount capital gains tax rule.

Start-ups – the big winners

Those set to benefit the most from the new rules are eligible start-up companies.

"The amendments have largely been driven by pressure from the start-up sector, they should help attract and retain employees, which is especially advantageous for cash-strapped start-ups." says Ms Quinsey.

The new start-up rules

The increase in the maximum tax deferral period from seven years to 15 years is a significant change for start-ups who are taxed under the deferral rules rather than under the new start-up rules. This change now provides sufficient time to realise growth within a start-up business.

Additional concessions will apply to employees of eligible start-up companies if the employer and the scheme meet a number of conditions:

- firstly the ESS interest must be over ordinary shares and must generally be held for at least three years
- a discount of up to 15% on shares will be tax-free. Any further gains will be taxed under the capital gains tax provisions
- tax on options issued with an exercise price of at least the value of a share at grant will be deferred until a sale event and taxed as a capital gain
- the period for which an option has been held will count towards the 12-month holding period, for access to the 50% discount capital gains tax rule. This is very good news and a key benefit of these new rules
- the ESS interest must generally be held for at least three years.

In order to be considered an eligible start-up the following conditions must be met:

- The employer company must be an Australian resident company.
- The eligible start-up company and other companies in the group must be: unlisted, incorporated for less than 10 years and have an aggregated turnover of less than $50 million for the income tax year prior to the year the ESS interest was acquired.
- These requirements will not apply to an investment by a tax-exempt entity which is an eligible venture capital investment by a venture capital limited partnership, early stage venture capital limited partnership, or an Australian venture capital fund or for an investment by a deductible gift recipient.

Safe harbour valuations

As part of the amendments the ATO has issued safe harbour valuation guidelines which provide approved market valuation methods which can be used, giving companies a choice as to whether or not to undergo a formal (often costly) valuation.

What to consider

If you are granting ESS awards, you should consider how these changes will affect your existing plans and whether they should be updated to access the extended tax deferral, or new start-up rules.

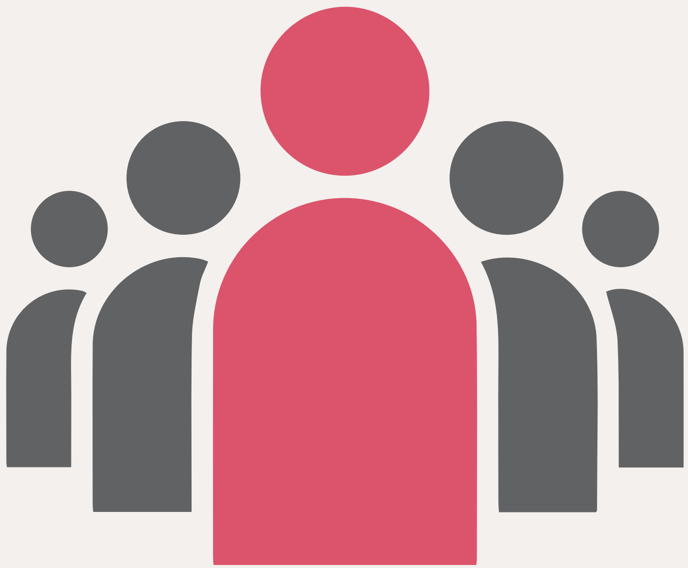
Pre 1 July 2015 ESS awards will continue to be taxed under previous rules.

Salary sacrifice plans may now be reinstated, and this should be considered as part of an overall award plan review.

Contact your PwC advisor to discuss how these changes may benefit your employees.

Article 2

Leadership



Leadership insights: Managing and developing leadership talent in your organisation

Rob Kaiser, an advisor, author and internationally recognised authority on leadership, recently joined PwC's private clients for a breakfast discussion focused on managing and developing leadership in small to medium enterprises.

The founder of Kaiser Leadership Solutions, Rob has spent decades consulting with large multinationals as well as smaller businesses. Based on this experience, he emphasises one key element to managing talent: "Get involved with your people."

While leadership takes many forms, Rob maintains that it is primarily about influence. The challenge for executives in organisations of all sizes is to encourage people to set aside their own agendas and "work together for some overall vision".

Gaining a competitive edge through leadership development

Why is managing leadership talent so crucial? According to Rob, “The sustainable source of competitive advantage is your people” and that, crucially, “you have to keep developing people to keep them around.”

While technology will continue to accelerate change in the business landscape, people are still paramount. So managing human resources through recruitment, succession planning, assessment, development and retention remains pivotal.

Walking the talk

Finally, Rob re-emphasises relationships as integral to successful leadership development. Acknowledging that “we are social animals”, Rob says building relationships “beyond a simple transaction” is time well spent.

To develop the next generation of talent, relationship development must be embedded in your leadership culture. “Do you personally walk the talk?” Rob prompts leaders to ask themselves.

“Your leadership culture is a reflection of your values and actions … You can’t talk about how important leadership is and then ignore it. What do you focus on? Do you reward poor behaviour? Not tolerate it? Actively punish it? Or simply ignore it? That sends a more powerful message than anything you can say.”

Providing developmental experiences

When asked about crossover opportunities to expand employees’ experience within the company – for instance, having a behind-the-scenes analytics employee manage the customer interaction on a deal – Rob shared three main ideas for optimising the experience.

First, he says there has to be something at stake. Second, the experience has to be new and different for the employee. Finally, Rob warns against throwing people into the deep end. Support is essential to making the development experience worthwhile.

Rob also addressed the importance of broadening people’s experiences to enrich their leadership potential.

“If you want to help somebody succeed at the top of the organisation, to really grow as a leader,” Rob says, “they have to develop a wide repertoire. Teach them thinking skills in particular and have them deal with a wide range of issues” – especially if they are outside their comfort zone.

Action steps to improve your talent pipeline

So how can you take immediate action to improve talent development in your organisation? The first thing Rob recommends is to “get personally and intentionally involved”. That means “not just reacting”.

Next, he suggests creating a succession plan — even if it is just a simple sketch. Identify key positions and determine “how talent plays out over the next five to seven years”. Or, start with a three- to five-year plan or even a one-year plan. The key is to think ahead.

“

Adding to the talent equation, Rob asks,

Are you going to build talent or are you going to buy talent?”

When building talent, it is essential to identify what high potential means in the context of your organisation. “Performance is not potential,” Rob says. He cites eagerness to learn, drive and the ability to succeed in any situation as attributes that will transfer to a new position, providing more insight than simply looking at current performance.

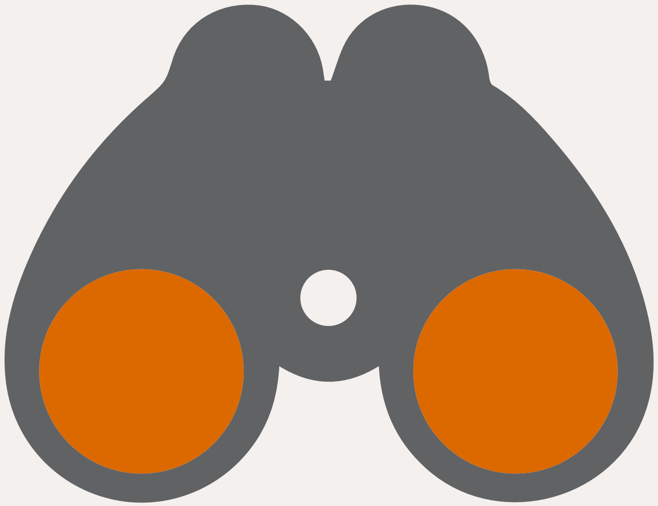
“Periodically assess your people,” Rob adds. “Periodically, systematically think through your key positions, and then have a conversation. Be explicit, formal and disciplined about engaging with the talent.”

The 360-methodology is a valuable way to supplement your perspective and create a more holistic picture of people’s strengths by gathering peer input as well.

In addition to feedback, coaching and mentoring, Rob encourages leaders to establish a retention strategy that goes beyond equity or stock options. “Give them the opportunity to do something,” he says. “Give them the resources to be successful.”

Article 3

Division 7A reforms



Division 7A reforms – are we any closer?

The Board of Taxation's Report on Division 7A of the *Income Tax Assessment Act 1936* was released by the Government on 4 June 2015.

The report includes a number of recommendations designed to ease the compliance burden associated with rules that govern distributions from private companies and to lower the cost of working capital for private businesses.

Four guiding principles

The Board considers that the first step in the process of improving Division 7A is to develop a coherent set of policy principles. The Board is proposing four guiding principles for the policy that could be incorporated into its framework:

- It should ensure that the private use of company profits attracts tax at the user's progressive personal income tax rate.
- It should remove impediments to the reinvestment of business income as working capital.
- It should maximise simplicity by reducing the compliance burden on business and the administrative burden on the Commissioner of Taxation (Commissioner) and other stakeholders.
- It should not advantage the accumulation of passive investments funded by profits taxed at the company tax rate over the reinvestment of business profits in active business activities.

The Board believes that the proposed principles provide a coherent, workable framework to guide future reform of the Division.

'Business Income election'

The Amortisation Model has an additional feature that will assist trading trusts wishing to reinvest profits as working capital. This is a 'business income election' exemption, under which unpaid present entitlements (UPEs) owed to corporate beneficiaries will not be subject to Division 7A if the trustee agrees to forgo the CGT discount concession on assets other than goodwill.

The Board believes this exemption will deliver significant benefits in terms of resolving the current uncertainty surrounding the use of UPEs while providing a more level playing field in the private business sector.

In our experience, the profits first nature of Division 7A coupled with its onerous compliance requirements has left many clients regretting their decision to hold assets in trusts. The ability to elect out of the operation of the Division 7A rules (even partially) is therefore particularly welcomed.

Amortisation model

To give effect to these four guiding principles, the Board has developed a reform model called the '*Amortisation Model*'. Key features of this model include:

- No requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist.
- The statutory interest rate would be set at the start of the loan and fixed over the term of the loan.
- The interest rate for complying loans to be based on the RBA's indicator overdraft variable lending rate for a small business.
- The maximum loan term would be 10 years.
- Prescribed maximum loan balances would be set over the life of the loan (i.e. 75% of the original loan by the end of year three, 55% of the original loan by the end of year 5; 25% of the original loan by the end of year eight; and fully repaid by the end of year 10).
- Subject to meeting the maximum loan balances, there would be no specified annual principal repayments.
- Interest would be able to be accrued annually but would have to be paid by the end of years three, five, eight and 10.

We support the introduction of a new, simplified regime to replace the existing provisions in Division 7A relating to complying loans. Removing the requirement for a formal written agreement is a sensible first step.

Fixing the statutory interest rate at the start of the loan would provide certainty for loan recipients in terms of their future cash flow requirements. However, applying a fixed rate of interest to the loan may lead private businesses to borrow from banks where variable interest rates may be available. Ideally, loan recipients should instead be given the choice to either fix the interest rate at the start of the loan period or adopt a variable rate of interest throughout the life of the loan. It would therefore be up to the loan recipient to decide how complex they make their own lending arrangements.

It is important to provide flexibility around principal and interest payments as, due to the nature of the business or investment activity undertaken by the loan recipient, it may not be possible to make annual payments of interest and principal.

However, we consider the approach taken by the Board in relation to the minimum loan balances required at key milestone periods does not go far enough to relieve private businesses of the pressures to repay principal prior to the end of the current loan term and does not provide them with any refinancing options in the event that payments cannot be made. To enforce the repayment of principal over the term of the loan (albeit at staggered intervals) is effectively introducing a quasi 'profits first' rule for private companies and is putting private businesses at a competitive disadvantage.

‘Interest only Model’

If the Government adopts a policy framework that omits the fourth principle, the Board has recommended that it consider implementing an ‘Interest Only Model’.

Key features of this model would include:

- No requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist.
- A variable statutory interest rate would be set annually.
- The interest rate for complying loans to be based on the RBA’s indicator overdraft variable lending rate for a small business.
- No prescribed term for the loan, no required annual principal repayments, and reborrowings (of principal) would be permitted.
- Giving taxpayer the option to apply an otherwise deductible rule exemption, in accordance with which there would be no requirement to charge statutory interest where company loans or UPEs were used by a borrower for a deductible purpose.

The main advantages of this model are its simplicity and the flexibility it provides to private companies – these are both welcomed. However, the Board considers that by sacrificing the fourth principle, the model would encourage passive wealth accumulation by using profits taxed at the company tax rate. The implementation of this model may therefore involve substantial revenue costs.

This statement by the Board as to revenue costs is very broad and may not apply to all taxpayers. Revenue costs associated with this model will vary and be dependent on factors such as the rate of growth of the underlying assets, timing of any divestments and the tax status of the lender.

Additional recommendations

The Board has also proposed some reform elements that could be adopted in conjunction with either the Amortisation Model or the Interest Only Model. They are:

- Introduction of legislative amendments to align the treatment of UPEs with the treatment of loans for Division 7A purposes. This appears to be a sensible approach.
- Simpler rules for regulating the use of company assets by shareholders and associates including the provision of safe harbour rules. Hopefully we will also see a shift towards 'actual' use rather than simply a 'right to use'.
- A 'self-correction mechanism' coupled with proportionate penalties to promote voluntary compliance.
- A new approach to imposing and remitting administrative penalties on deemed dividends.

Where to from here?

Whilst the Board would welcome a longer-term commitment to redesigning the tax system, including the interaction of Division 7A with others parts of the legislation (e.g. taxation of Trusts), the potential for such reform does not in their view reduce the urgent need for improvements to Division 7A.

The Government has not indicated whether it supports the Boards recommendations. Instead they have stated that these recommendations will be considered alongside the submissions they have received in response to their *Re:Think*, tax discussion paper.

Despite the urgent need for Division 7A reform, it may therefore be some time before we see amending legislation in this area.

Contact your PwC advisor to discuss any tax planning options.

In the news:

Family, Business and Wealth

"Every family has a story, only a few leave a legacy"

Click here for press release

Family-owned businesses face unique challenges but also have unique strengths.

Where other businesses might measure success in financial years, some families measure it in generations. Where others might focus solely on value, families also focus on values – including preserving the family business for the next generation, or leaving a lasting legacy.

On the other hand, family dynamics and non-business considerations can derail even the most profitable business. Events such as a generational transition or an external economic crisis can result in additional business and financial pressures.

Last week the BRW's Rich Families list was released. David Smorgon, Executive chairman of PwC's Family, Business & Wealth team commented in the BRW on the release of this list, below is a snapshot. To read the full article click here.

The criteria used in the BRW list is determined by financial success, but does money define richness? Can we redefine wealth away from the balance sheet to a more balanced life, a healthier family dynamic? From our experience there can be a huge gap between the wealth and the health of many families. PwC's Private Clients, believe there's a new type of currency that's just as significant, if not more important, to these successful families to create a richer life. As part of our family, business and wealth offering the team conduct a 'health check' which rates family businesses on a scale to indicate the health of the family, determined by family dynamics and family relationships.

Family businesses are failing for family reasons, not for business reasons. There is too much emphasis on business matters at the expense of family issues. Ninety nine percent of most families' time is spent on the business.

A culture of avoidance and deflection arises that reinforces the inability to sit down and have face to face family conversations, which leads to different expectations between generations. Their inability to talk ensures tensions and disagreements continue and potentially move into conflict – serious conflict, which becomes linked to anger, fear, envy and emotions – a volatile and potentially deadly mix in a family business.

In the news:
Family, Business and Wealth

Managing family wealth successfully can sometimes be as difficult as creating it in the first place.

24%

plan to pass the business on to the next generation

According to PwC's 2014 Family Business Survey only 24 per cent of family businesses plan to pass the business on to the next generation, and with most family businesses failing by the third generation, multi-generational businesses and wealth are under threat. Creating a strong family environment combined with the giving of freedom to individuals to express themselves, to show their passion and to have their own self-respect, is paramount to family continuity and family harmony.

So is it time for Australian family business owners to re-evaluate what rich is, to rebalance their priorities and spend more time with their family, and give their children something that money can't buy – direction, guidance, support and love. A different kind of rich – a richer life.

A successful family business requires hard work, commitment, collaboration and understanding. It requires creating a process and infrastructure of open communication, governance and a family plan to provide the framework for family success. It requires understanding that there are options, there are systems and processes that can assist. For more information speak to your Private Clients advisor today or contact Stuart Morley, Head of Family, Business and Wealth for PwC's Private Clients.

Wealth services form part of our 'Family, Business and Wealth' offering for Private Clients. The team work with families to identify the values that guide their spending, saving and sharing of wealth, with a view to maintaining or establishing family harmony. This approach assists families to make the most of their financial assets by considering their non-financial assets.

As important as getting the right investment advice is working with an advisor that understands the unique dynamics and challenges of family business. Our aim is to support our clients and their families now and into their future - to leave a lasting legacy.

For more information on PwC's wealth services click here