Exiting a business

How to put in place effective governance to manage the tax issues associated with disposing or closing your business.

QC 49156

Disposing of your business

Learn about tax governance when disposing of (selling) your business.

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Selling a business

The sale of a business generally occurs through the disposal of either:

- the shares or other ownership interests in the entity that conducts the business
- all of the tangible and intangible assets in the business.

When preparing to dispose of your business, we encourage you to consider your tax governance for the transaction and the tax consequences.

For more information, see:

- Market valuation of assets
- Changing, selling or closing your business
- What attracts our attention

Record keeping

Both the vendor and purchaser need to retain documentation evidencing the transactions, including:

- contracts
- minutes of meetings recording why the business was to be sold and decisions relating to the transaction by the directors and other key decision makers
- communications between the vendor and purchaser relating to the negotiations, including any allowance for liabilities
- details of the assets disposed of under the contract, the apportionment of the purchase price to the various assets and the basis for the apportionment
- capital gains tax (CGT) calculations, including the
  - allocation of purchase price to depreciating assets
  - basis for this allocation
  - treatment of consideration held in escrow

- any advice detailing why the particular tax position has been taken
- settlement documentation
- asset registers
- trust resolutions creating income or capital entitlements of beneficiaries.

Revenue or capital transaction

Where you dispose of an asset, you need to determine whether it should be treated as a revenue or capital transaction.

You can find relevant information and views in documentation, such as minutes of meetings, business plans, documented discussions with stakeholders and consultants and financial statements.

Disposing of a business to a related party

Where you dispose of the business to a related party, you should get an independent valuation of the business, including the goodwill, assets and contractual rights being disposed of.

Interest expense

There may be an impact on the interest expense that can be deducted if the disposal of an ownership interest in a business results in a change to the entity's debt to equity ratio. You may need to recalculate this at the relevant time.

Disposing of part of a business

You may partially dispose of your business by:

- creating a new class of shareholders or unit holders, or by amending rights for existing share classes
- disposing of a portion of shares
- retiring from a partnership
- admitting a new partner into your partnership.

As a result of the above changes, you may need to amend key documents such as the company's constitution, trust deed, or partnership agreement.

The rights of the existing shareholders or unitholders may also be affected. Where this occurs, the existing shareholders, unitholders and partners should consider any tax consequences, such as capital gains, value shifting and limitations on future deductions or capital losses.

More complex business disposals

More complex or non-traditional business disposals often give rise to a range of tax issues and require risk mitigation. Good tax governance will ensure that you identify, assess and manage these issues.

You should carefully consider and document transactions and the commercial business drivers.

Some of the more complex business disposals that may require additional tax governance include:

- earn-out arrangements
- scrip-for-scrip rollovers
- **share buy-backs** and capital reductions
- **business restructuring**
- listing on a stock exchange
- exit from a consolidated group
- the use of a demerger to facilitate the disposal of the business
- multiple events and transactions that occur just before or on the date of the business disposal.

We encourage you to seek advice from a tax adviser if you are unsure of the tax consequences.

You may also wish to **engage with us for advice** directly before entering the transaction. We can help reduce uncertainty by clarifying how the tax law relates to your particular circumstances.

Earn-out arrangements

The disposal of a business that includes an earn-out arrangement can take several forms. Good governance practices include:

- retaining the sale contract and other relevant agreements

- considering changes in the law examining the terms of the earn-out arrangement and identifying the contingent and non-contingent rights
- considering if there is a reverse earn-out arrangement
- estimating the value of the earn-out right and retaining documentation to support the estimate
- getting tax advice and preparing the capital gains tax calculations for the income year in which the disposal occurred
- comparing the amounts actually received under the earn-out clauses to the amount estimated.

Scrip-for-scrip rollovers

When you have a CGT event that results in a capital gain, a rollover may be applied, for example, a scrip-for-scrip rollover. Generally, this occurs where a seller exchanges a share in a company (or trust interest in a trust) for a share in another company (or trust interest in another trust).

Effective governance involves retaining key documentation to provide you with certainty. It should be readily accessible if we review the transaction.

Key documentation to retain may include:

- minutes of meetings or other documentation recording proposals, deliberations and negotiations prior to entering into the transaction
- minutes of decisions to proceed with the transaction and executed contract documents
- evidence of the interests exchanged (such as share certificates or unit registers)
- details of the CGT profile of interests, such as cost base and any pre-CGT status
- valuations
- other workings, papers or advice setting out the conditions and how they have been satisfied.

Listing on a stock exchange

Where a business owner is looking to dispose of the shares in a business via listing on a stock exchange through an initial public offering (IPO), back-door listing or reverse take-over, good tax governance practices may include:

- considering the Australian Securities Exchange (ASX) and Australian Securities and Investments Commission requirements and their tax consequences
- getting advice on the CGT treatment of any disposal of shares held by the existing shareholders
- documenting the transactions and tax impacts, including considering whether the CGT discount and a full or partial CGT rollover apply
- considering how any additional amounts to which the existing shareholders are entitled after the event (such as additional shares or earn-out amounts) will be treated for tax purposes.

A back-door listing generally involves the disposal of an entity's shares or assets to a company that is currently listed on the ASX. Interests sold between related parties through back-door listings should be subject to independent market valuations.

Exit from a consolidated group

Where a consolidated group disposes of a partial or the full interest in a subsidiary member, resulting in it leaving the group, effective governance practices include:

- retaining the sale contract and agreements
- preparing a statement of financial position in accordance with accounting standards as at the date of exit
- ensuring that the assets and liabilities appearing on the statement of financial position reflect market values
- undertaking allocable cost amount exit calculations
- calculating the capital gain or loss resulting from the disposal of the interest in the subsidiary member
- getting a valuation to determine the subsidiary's market value where the purchaser is a related party
- notifying us of any changes to membership.

For more information, see **Consolidation**.

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Closing your business

How to ensure effective tax governance if you're closing some or all of your business or private group structure.

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Closing an entity in your private group

You may decide to close an entity in your private group or your entire business.

The disposal of assets, liquidation or vesting of entities may have tax consequences.

Effective tax governance when closing a business will help mitigate risk and provide practical certainty for stakeholders.

For more information, see **Changing, selling or closing your business**.

Companies

When a company is wound up, liquidated or deregistered, you should retain documentation for tax governance purposes. This may include:

- contracts for sale of assets

- documentation to evidence the forgiveness of loans
- minutes of meetings.

In some cases, you may be legally required to retain this information.

Example: winding up a company

Spin Records has been a profitable company for many years. However, due to a change in consumer demand and the economy, its company directors believe it is no longer viable to continue to carry on the business.

The directors decide to liquidate and deregister Spin Records before it becomes unprofitable, rather than dispose of the business. They agree to engage a liquidator to start winding up the company in 3 months. This allows it to fulfil its final contracts with customers.

Before commencing liquidation, a dividend is declared and paid to the shareholders. The assets of the company are then sold. The proceeds and cash reserves are used to pay creditors. Loans provided to shareholders are forgiven. A final dividend is declared by the liquidator and paid to shareholders before the company is deregistered with ASIC.

Spin Records needs to retain the following documentation for tax purposes:

- minutes of meetings documenting key decisions relating to the winding up, liquidation and deregistration
- minutes of directors' meetings relating to the dividends declared and paid
- minutes of meetings conducted by the liquidator
- analysis of the tax consequences of the sale of assets and the forgiveness of loans to related parties
- the final tax return and details of payment of tax liabilities.

The company’s shareholders also need to keep documentation to substantiate the cost base of shares in the company for capital gains tax purposes.

For more information, see:

- Winding up a company
- Deregistering a company

Trust vesting

Where a trustee is intending to vest a trust, they should carefully examine the trust deed to ensure adherence to its terms.

The trustee should:

- Make written trust resolutions to record the trustee's decisions throughout the vesting process. This is particularly important where the trustee has the discretion to exclude the distribution of income or capital from the winding-up process to one or more beneficiaries, unit holders, or classes of unit holders.
- Document forgiving or assigning related entity loans receivable and payable, and determine the tax consequences of forgiving a loan.
- Examine the rights attached to each unit class, where the trust is a unit trust. This will determine which unit classes are eligible to receive distributions if the trust is being wound up.
- Record the decision made if the trust deed provides for the trustee to transfer assets to a beneficiary or unit holder to satisfy a distribution of income or capital where the trust is being wound up.
- Consider getting a **market valuation of the asset**. This will show that the asset being transferred does not exceed the amount to which the beneficiary or unit holder is presently entitled. A transfer of the asset could potentially result in a capital gains tax event to the trust. The trustee should consider the tax consequences.
- Notify beneficiaries and unit holders of their share of the income or capital of the trust so they can determine and report their tax obligations.

Partnerships

Where a partnership ends, a final partnership distribution will be necessary.

Each partner will need to retain documentation to substantiate the cost base of their respective interest in the partnership for capital gains tax purposes.

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Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.