



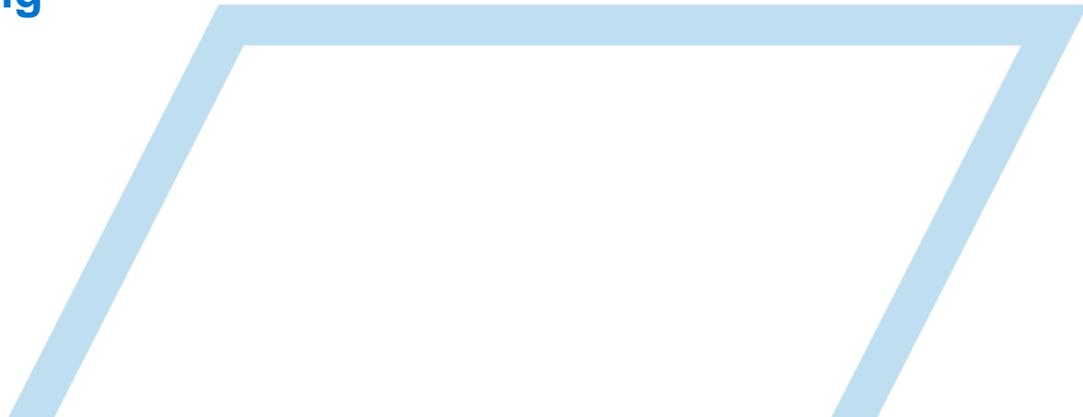
Setting up for Succession

Sheryl Troup, CPA, CA, TEP, CFP

Director, Tax & Estate Planning

IG Wealth Management

June 2019



Why Plan Now?

- Business owners sometimes say “My business is not complex or big enough to warrant a tax and estate plan”.
- But quite often, this is not the case – a plan’s value is maximized when implemented before it is truly needed. Think about it. If we don’t worry about creditor protection until there is a known creditor threatening to sue, or we don’t plan for the succession of the business until there is a medical emergency, fewer planning opportunities may be available.
- Having a plan in place today can help ensure that your client’s assets are protected, their business carries on profitably, and maximize their wealth potential.

Why Plan Now?

- A tax and estate plan is just that, a plan! Without proper planning, good intentions are often just not enough.
- Your client, as a business owner, has put significant time, resources, and effort into making their business successful. So how do they proceed with protecting that value? A proper tax and estate plan works with them and their business throughout its life cycle to ensure they are maximizing wealth and minimizing taxes, both now and in the future.

Why Plan Now?

- A business can be operated using three types of structures: sole proprietorship, partnership, and corporation.
- Tax and estate planning affects all business owners; but as most profitable businesses are incorporated, we'll focus on tax and estate planning considerations within a corporate structure.
- These include income splitting, creditor protection, corporate investment, and succession planning.

Planning Considerations

Incorporated Businesses

Structure of the Corporation

- Proper structure can help or hinder various planning opportunities
- Set the structure up right
 - Multiple Classes of shares
 - Discretionary Dividends
 - Future freeze opportunities
 - Family Trust?
 - Holding company?
- Ensure the client is working with advisors who can help navigate how best to set up their corporate structure
- Okay to change the structure to suit current vs. future needs, don't buy a Cadillac when the Kia will get you where you need to go!

Income Splitting

- Providing income to actively involved family members
- Salary vs. Dividends
- Tax on Split Income – “kiddie tax” now can apply to adults
 - Three general exceptions:
 - Excluded Business – work on average 20 hours per week
 - Excluded shares – direct ownership of 10% or more votes and value
 - Reasonable return – most difficult to quantify

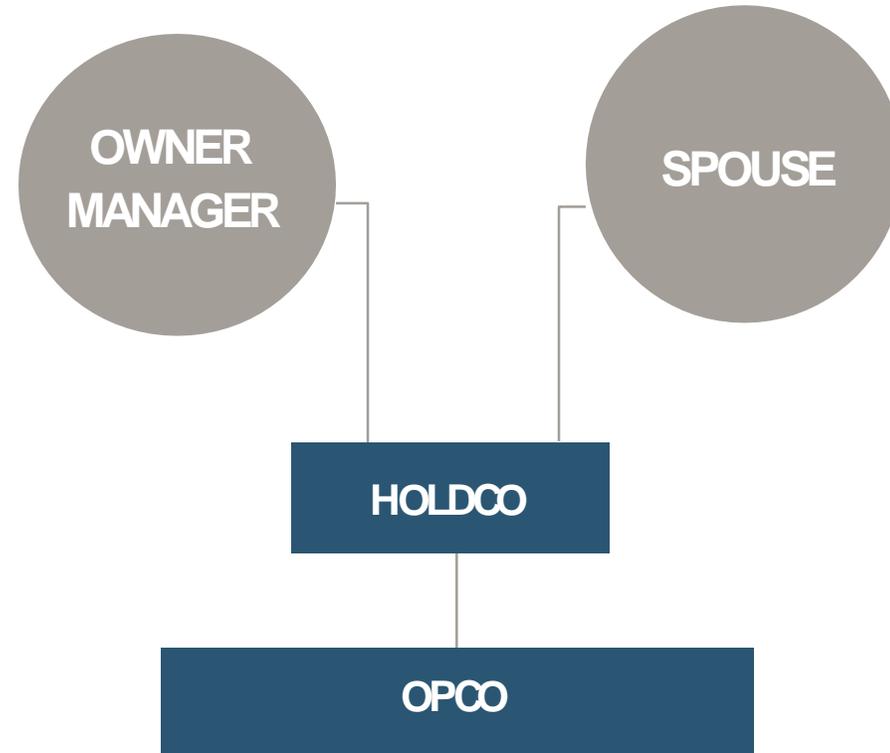
Income Splitting – use of Family trusts

- Family trust holds shares of the corporation
 - Allocation of income can be discretionary
 - Control remains with trustees – no direct share ownership
- Difficulty with TOSI
 - New rules generally require persons to be involved in the business in order to income split with family members through a trust
- Multiplication of capital gains exemption
 - In the event of a share sale, gains can be allocated to various family members, allowing them to use their own lifetime capital gains exemption

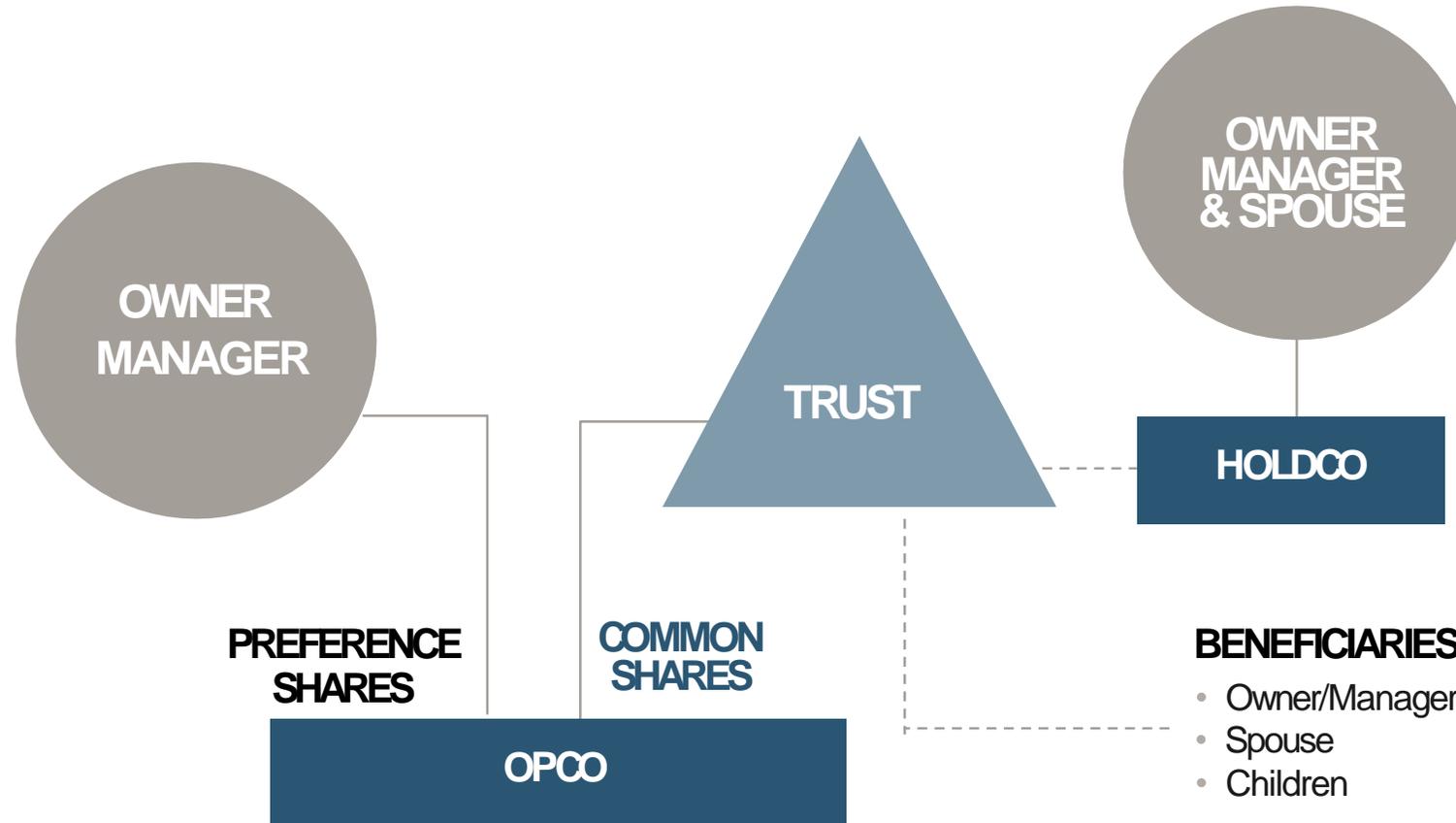
Creditor Protection

- Known and unknown
- Different structures function better to accomplish creditor protection in addition to other goals
- Strategies can be complex with recent tax changes – always work with a good tax accountant

Creditor Protection – Holding Company Structure



An Alternative Organizational Structure



Corporate Investment

- Allows for personal tax deferral
- Be aware
 - High rate of corporate tax applies to passive investment income
 - Can affect ability to access lifetime capital gains exemption in the event of a share sale
 - Can expose assets to corporate creditors (see creditor protection strategies)
- Investing at the individual level is critical too
 - RRSP and TFSA – allow for tax deferred investment growth

Shareholder Agreements

- Key to enter into such agreements when the parties are getting along
- Sets out the division of duties
- Decision making guidelines
 - Should include remedies for disagreement
- Deals with events we don't like to think about such as:
 - Death
 - Divorce
 - Incapacity

Shareholder Agreements

- Often when persons are in business together, their dynamic is special
- But when that person dies, do the remaining parties wish to be in business with that business partner's family?
- Shareholder agreements provide an agreed upon remedy to situations such as death
 - Often results in a buy-out of the shares of the deceased party

Shareholder Agreements – Buy out

- Most agreements will provide for the buy-out of a shareholder if certain events occur such as death
- Often the remedy is for the corporation to re-purchase the shares of the affected party
- Alternatively some agreements call for other shareholders to purchase the shares
- When the event is the death of a shareholder, insurance often utilized to provide a way to fund the purchase of the shares

Life Insurance

- As previously noted, life insurance can assist with buy-out funding
 - Provides cash to allow for the purchase of the deceased shareholder's shares
- Life insurance also helps with estate preservation
 - Provides the estate with liquidity so that the tax liability owing on death is funded by insurance rather than estate assets
- Can be a tool to equalize an estate
 - Particularly important when certain assets are destined for certain beneficiaries

Wills and Powers of Attorney

- Key documents used to ensure your intentions and wishes are carried out upon certain events
- Wills address wide range of issues for business owners:
 - Distribution of business assets to certain family members
 - Allocation of other assets to non-business beneficiaries
 - Use of testamentary trusts to control distribution of significant wealth
 - Dual wills to avoid probate associated with private corporation shares – available in Ontario and B.C.
- Powers of Attorney – voting control over shares held or even act in the owner-manager's capacity within the corporation

What Increases the Value of a Business?



RECURRING REVENUE



KNOW YOUR POTENTIAL BUYERS



CONCENTRATION OF CLIENT & SUPPLIER RELATIONSHIPS



CLARITY OF FINANCIAL STATEMENTS



VISIBILITY



PLAN FOR MANAGEMENT SUCCESSION

Succession Planning

Considerations when transitioning the business

Succession Planning

- When
 - Timing is key
- Who
 - Third party sale
 - Key employee
 - Next Generation
- How
 - Sale
 - Estate Freeze

When – Timing is Everything

- May be planned in advance or when opportunity knocks
- Enough value accumulated?
- Next Generation or key person wants ownership role
- **The key is for your client to be aware of their financial position at all times in order to be in a position to make the decision when the time comes**

Who

- May be a difficult decision
- Third Party Sale
 - Immediate monetization
 - May or may not include continued involvement
- Key person or Next Generation
 - Requires effort to groom
 - May require receiving value/payment over time

How

- How to monetize the business of often a difficult decision for business owners
- The business is often the major asset held by the owner-manager, therefore need to access that value to sustain retirement income needs
- For incorporated businesses, several options available

How

- Third Party sale
 - Share sale vs. Asset sale
- Key Person or Next Generation
 - Sale or Estate Freeze

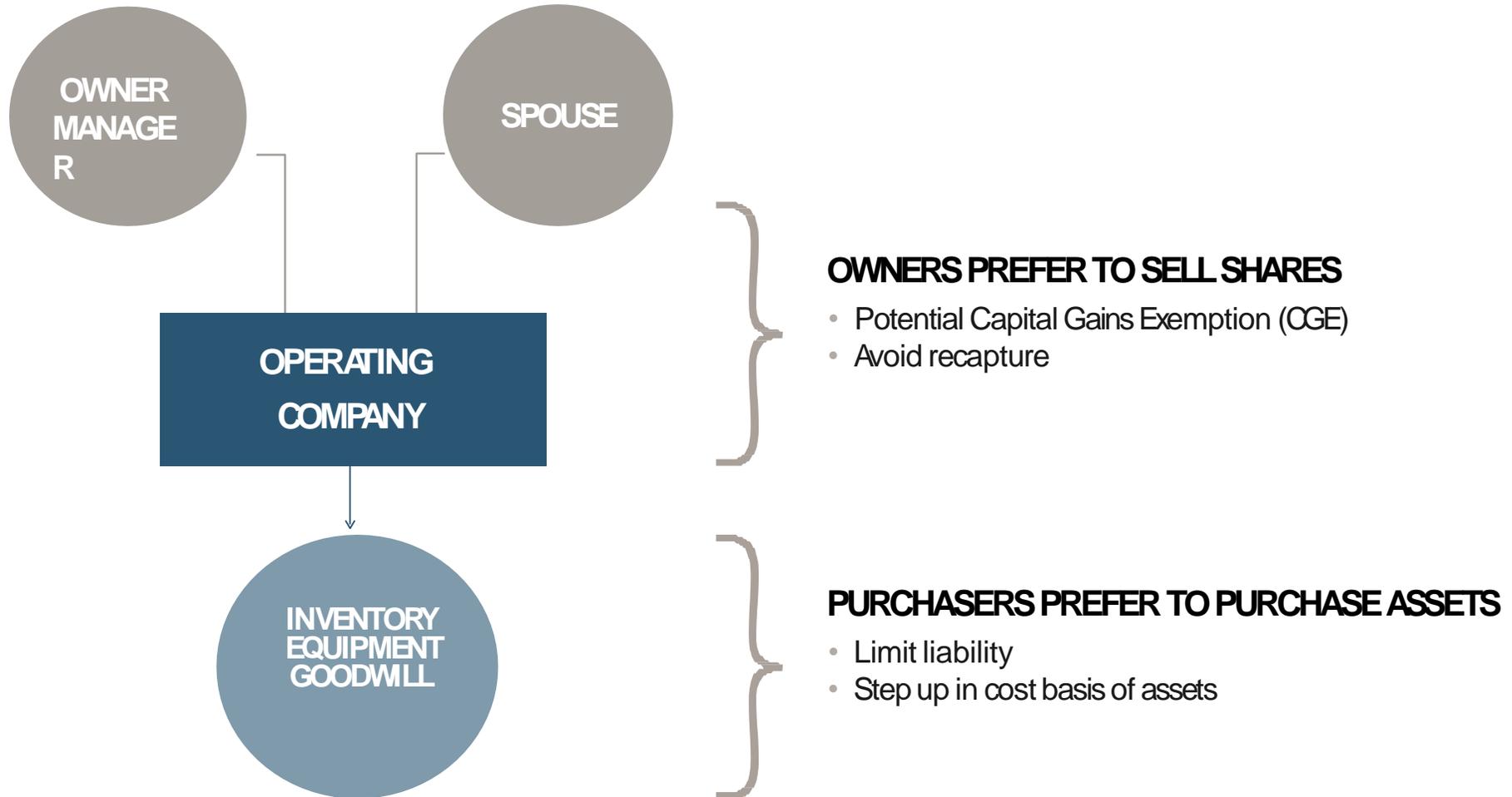


Sale Considerations – Arm's length

- The following deal with considerations in the context of the sale of a business
- Can also apply to a non-arm's length sale but other issues can arise – work with a knowledgeable tax accountant



Share Sale vs. Asset Sale – Conflicting Objectives

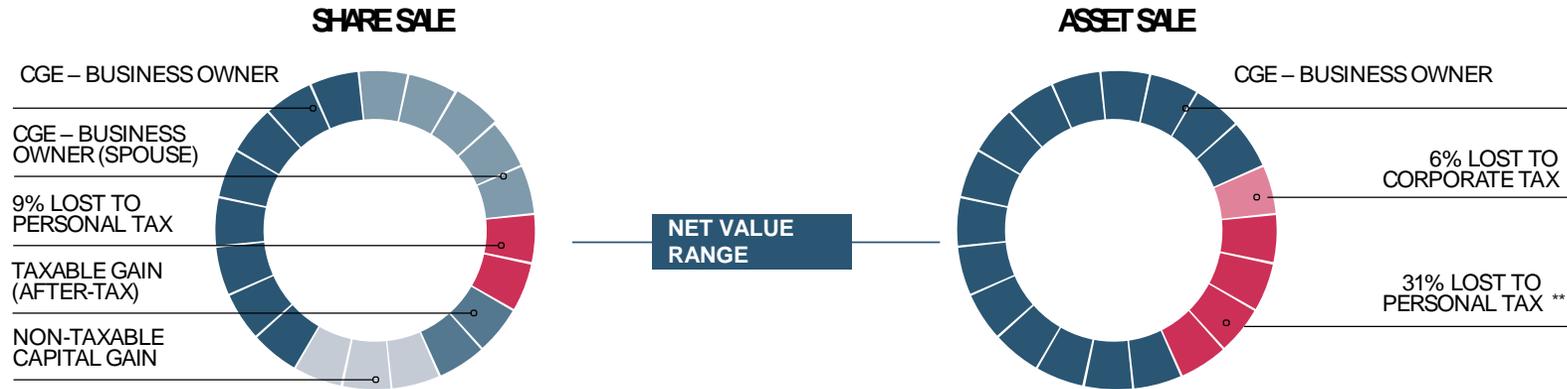


Share Sale – Lifetime Capital Gains Exemption

- **There are a number of criteria that must be met to qualify for the LCGE – the key takeaway being, that you must stay on top of planning to realize your full exemption.**

- **Benefit from the capital gains exemption**
- Capital gains of up to \$866,912 tax-free on sale¹ of certain corporate shares by an individual
- To be eligible the corporation must be a “qualified small business corporation” (QSBC):
 - At time of sale: 90% of value of assets used to earn income from an active business
 - Two year period prior to sale: 50% of value of assets used to earn income from active business
 - Among other criteria
- May need to “purify” Opco periodically to preserve exemption
- Can multiply CGE when family members own shares
- ¹ Or “deemed” sale in the case of death

Share Sale Vs. Asset Sale



SHARE SALE	
Total Proceeds of Sale	2,500,000
Cost Base on Shares	(100)
Personal Tax (assume 50% tax rate)	(207,000)
Total Cash to Shareholders	2,293,000

ASSET SALE	
Total Proceeds of Sale	2,500,000
Corporate Tax*	(138,800)
Personal Tax**	(768,100)
Total Cash to Shareholders	1,593,100

\$693,900 (AFTER-TAX) SUBJECT TO NEGOTIATION

* Assumes taxable gain on goodwill & other assets of \$575k taxed at 20% tax rate on investment income, net of RDTOH; and CCA recapture of \$170k taxed at small business tax rate of 14%.

** Assumes non-eligible dividends of \$1.79M distributed to shareholders, taxed at 43%.

Share sale vs. Asset Sale

- Important aspects to consider...
- Share sales tend to command a lower purchase price
- Tax Impacts of an asset sale can be minimized if the proceeds are removed from the corporation over time and are subject to the shareholder's lower marginal brackets
- Important to work with qualified advisors to help through the decision making process

Sale Considerations – Non-Arm's length

- When transitioning the business to a key person or the next generation, another option typically is available



- The “Estate Freeze” allows for only future growth to transition to another person

Succession Planning

Estate Freeze

- An estate freeze is a mechanism whereby the value created to date is “frozen” in the form of fixed-value preferred shares, and the next generation then becomes the new common shareholders.
- Done on a tax deferred basis
- This allows for all future value (and the applicable tax liability) to move from the owner-manager to the next generation. There are multiple ways to accomplish an estate freeze.

Types of Freezes

- **Complete Freeze**
 - Owner-Manager has no future access to growth
- **Partial Freeze**
 - Owner-Manager has less access to future growth than today
- **Complete Freeze with Family Trust**
 - Allows for flexibility

Estate Freeze – Timing considerations

- Sufficient value accrued to date
 - Estate freeze is a way to control value – often done when shareholder has more than enough value for personal needs throughout lifetime
 - Caps anticipated value held upon death – limits anticipated tax on death
 - There is an expectation that the corporation will continue to grow in value
- Need to have key person or next generation have direct ownership
 - Often these persons need more skin in the game, direct ownership can create a greater connection to the business

Estate Freeze with a Family Trust - Benefits

- Limit the exposure of the owner manager to tax on death
- Multiply the lifetime capital gains exemption
- Income split with beneficiaries that are 18 years of age or older and who actively participate in the business
 - Need to meet the TOSI Excluded Business Exception generally
- Owner-manager can remain in control and can defer to a much later date decisions regarding the eventual ownership of the business

Sale Considerations – Non-Arm's length

- Share sales can be beneficial if the key person or child is able and willing to pay the owner-manager for the value of the business
- **Bottom Line?**
 - Financed either through accepting proceeds over time or through a bank
 - Typically always needs to rely on corporate profits to provide ultimate cash flow
- **The corporation must remain PROFITABLE!**
 - Estate freeze beneficial when the key person or child has no financial means
 - Corporation funds the buy-out of owner-manager through share redemptions

Holding Value on Death

Tax implications of dying with private corporation shares

Taxation on Death – Holding Private Corporation Shares

- If there is no surviving spouse, generally upon the death of the taxpayer, a deemed disposition of the shares they held will occur
- On the final return of the deceased, the fair market value of the shares on the date of death will be reported as the “proceeds of disposition”
- If proceeds exceed adjusted cost base, a capital gain will be reportable

Taxation on Death

- If the shares are qualified small business corporation shares, the lifetime capital gains exemption may be available to reduce or eliminate the taxable capital gain reported on the final personal tax return
- If not, then the estate will pay tax on the taxable capital gain resulting from owning shares on death
- If there is insufficient liquidity in the estate, the tax liability associated with owning shares can create issues for the estate – may require estate to liquidate assets or extract funds from the corporation
 - Insurance again is an opportunity to provide liquidity to the estate

Taxation on Death

- When an estate pays tax on the deemed disposition of the shares and the beneficiary of the estate ultimately liquidates their interest in the company by extracting cash via a taxable dividend – double taxation occurs
- There are ways to reduce or eliminate double taxation
- Executor of the estate needs to be aware of the double tax potential so they seek out solutions early

Summary

- Closing thoughts
- There are opportunities at every stage of the business to focus on:
 - Tax Planning
 - Creditor Protection
 - Wealth accumulation (investments)
 - Succession and/or Exit Planning
 - Tax on death
- It is key for a business owner to develop a good team of advisors. This team should include: accountant, lawyer, and financial advisor – they all have a unique roll to play!

This presentation...

- Written and published by IG Wealth Management as a general source of information only. It is not intended as a solicitation to buy or sell specific investments, nor is it intended to provide tax, legal or investment advice. Readers should seek advice on their specific circumstances from an IG Wealth Management Consultant.
- Investment products and services are offered through Investors Group Financial Services Inc. (in Québec, a Financial Services firm) and Investors Group Securities Inc. (in Québec, a firm in Financial Planning). Investors Group Securities Inc. is a member of the Canadian Investor Protection Fund.
- Insurance products and services distributed through I.G. Insurance Services Inc. (in Quebec, a Financial Services Firm). Insurance license sponsored by The Great-West Life Assurance Company (outside of Quebec).
- Trademarks, including IG Wealth Management, are owned by IGM Financial Inc. and licensed to its subsidiary corporations.