



Wills, Taxes and Estate Planning Law

Issues in Law You Need To Know

Planning your Business Succession: What Needs to be Considered

A Henson Trust is an excellent way to allow for financial care for disabled children after the death of the parent(s). The terms Henson Trust, Absolute Discretionary Trust and Discretionary Trust are used interchangeably and refer to a very specific type of trust when used in the context of planning for a person with a disability.

Every successful business owner will one day be faced with the dilemma of having to choose a successor. Letting go of the reins of his or her business that has been built through years of labor will not be easy and a smooth succession can only be achieved if the business owner is ready to sell or pass the reins to his or her heir(s).

There is no single boilerplate for a succession plan for all businesses as every business succession is unique. However, all successful successions have similarities and I will highlight some of those similarities in this article.

Beat the Odds

The statistics on small business succession are discouraging as approximately 50% of small businesses that pass to the next generation of owners remain in business five years later. The statistics concerning family owned-business are less encouraging as only 30% will survive a next generation and probably only half of those will survive to the following generation.

Although the reasons why some business successions fail while others succeed are vast and open to interpretation, lack of preparation and poor communication are



common traits in many failed plans.

Shareholder Agreement

Most successful entrepreneurs



and professionals will agree that a shareholder agreement is important as it establishes a solid business foundation for the shareholders. The shareholder agreement can also provide the initial steps for planning the business succession as it usually maps out the structural transitions of the business in situations such as the death or disability of an owner, a marriage breakdown of a shareholder or the outcome of a feud between co-owners. Essentially, the shareholder agreement is a negotiated document between the shareholders of the business defining the relationship of the shareholders and the future succession of the business.

A well-drafted shareholder agreement provides solutions to those unfortunate situations

by inserting specific clauses that pre-determine the outcome. A shareholder agreement should include clauses such as:

Disability – addressing how and when the shares of a co-owner who becomes permanently disabled can be bought out.

Death – determining how to deal with the deceased owner's shares.

Retirement – determining the retirement income for the owners who cease to work actively in the business.

In our opinion, a shareholder agreement should always be part of the business succession discussion.

Have a Plan

Business succession planning is a process that should be considered sooner rather than later. To achieve a smooth succession of the business it is best to develop a comprehensive plan that both achieves the retiring owner's objectives and serves the successor's needs.

In an ideal scenario, the business owner(s) and the "next generation" would meet with a group of professionals (accountant, lawyer and advisors) to discuss their individual goals and the various options to attain these specific goals. The design of the plan should be viewed with an open mind as compromises are inevitable and without the input of all the succession would be vulnerable.

The succession plan should address three main areas:

- The transfer of labour
- The transfer of management and decision-making (control)
- The transfer of ownership.

However, the main issue to address in any succession plan is: who is/ are the successor(s) and how it will be accomplished. The answers to those questions will provide the basis for the structure of the business succession plan.

Implementing the Plan

Establishing a succession plan is only the first step of the business succession; that plan must then be implemented. It is often at this stage that plans derail because of a lack of willpower on behalf of the parties or because the plans are put on the backburner.

Once a succession plan has been agreed upon, someone must take the leadership role and establish the timetable for the stages of the succession. The leader must make sure that all parties involved (owners, accountant, lawyer and advisor) are made aware of the deadlines and, more importantly, he or she must ensure those deadlines are met.

It is possible that the succession plan may change in light of unforeseeable events so the parties involved must remain flexible and open-minded. However, unless those unanticipated events jeopardize the entire succession plan (such as the death of the owner), the succession plan should only be postponed and not dismissed in its entirety.

Tax Consequences

You must take into consideration tax consequences when implementing an estate and business succession plan.

If one voluntarily avoids preparing a business succession plan, at his or her death he or she will be deemed to have disposed of all his or her assets at fair market value potentially resulting in a significant tax debt payable by the estate and the business being left in complete disarray.

Deemed Disposition at Fair Market Value

One of the greatest concerns business owners face when planning for their estate and the business succession is how he or she can minimize the capital gains tax that will arise on the sale or other type of transfer of ownership.

As mentioned above, although avoiding the issue and letting his or her Will dictate the business succession is probably the worst choice one can make, unfortunately many owners prefer opting for this option in hopes of avoiding conflict because of the succession. If the business owner decides to leave their shares of their company to their children under their Will, they will be deemed to have disposed of these shares at fair market value triggering a capital gain which may potentially deplete the value of their Estate.

Capital Gains Exemption

Every individual resident in Canada is entitled to a lifetime capital gains exemption of up to \$750,000 upon disposition of shares of a qualifying small business corporation. To qualify for the exemptions the following criteria have to be met:

1. The shares must have been owned throughout the 24 month period preceding the date the shares were disposed of;
2. At least 50% of the fair market value of the business's assets must be used in the course of carrying on an active business in Canada;
3. At the date the shares are disposed, approximately 90% of the fair market value of the business's assets must be used in the course of carrying on an active business in Canada.

The capital gains exemption allows the business owner to contemplate several succession strategies such as an estate freeze.

Estate Freeze

One strategy that is often mentioned is the estate freeze; a technique that limits the growth of your capital property and the resulting tax on death during your lifetime by



transferring the future growth in the capital property to your heirs.

In order to protect their Estate by preventing its value to grow to a size that might incur considerable taxes and probate fees, the business owner will:

1. exchange their common shares for preferred shares of equal value where the new preferred shares would not grow; and
2. family members (wife, children and grandchildren) would be given common shares and all future growth would attach to those common shares.

An estate freeze allows for a tax deferral for a period commencing when the family members acquire the new preferred shares until the sale of those shares. The estate freeze allows the business owner to minimize the taxes arising at his death.

However, it is important to understand that an estate freeze involves major changes on the part of the business owner and the family. Several issues will also need to be addressed as a result of the freeze and we recommend that anyone who is contemplating an estate freeze consult their accountant and their lawyer in order to fully understand the implications of a freeze for the business and for the family members.

The estate freeze is the most common technique used when a business succession is contemplated but it is not the only technique. Depending on the situation, there are other techniques that are more complex and beyond the scope of this Newsletter. For more information, we recommend you consult your accountant and lawyer.

Succession of the Family Business - A Web of Complexities?

Succession of the family business is more delicate as it often involves the varying interests of the children and the parents' concerns of being fair toward them; it is a balancing act between the realities of the business and the family.

First, one must ask whether there is a viable family successor(s). It is also important to identify the goals of that successor(s) and to develop the right succession plan in light of those goals.

Second, involving family members in the business at an early stage provides an opportunity for the next generation to familiarize themselves with the requirements of managing the business to be involved in the decision-making process. Family involvement should be a key component of the

family business succession plan.

Third, it will be necessary for the family to address important and difficult issues such as management authority and family participation.

The emergence of a strong corporate governance plan will only be possible if all related parties participate in the generation of the plan and all recognize their responsibility in this plan. The ultimate goal is to have the parent recognize will be in the need to pass the reins to the next generation and having confidence that business is in good hands and will continue to thrive in the future.

Consult with Professionals

Business succession planning can strain the personal relationship of co-owners or your family members. However, maintaining the status quo and doing nothing is the worst option as it only postpones the issues and your legacy could be jeopardized.

Letting go is seldom easy but making well-informed decisions will make the transition less stressful and ensure your business transition results in a lasting and profitable gift. In contemplating retirement and handing the reins of



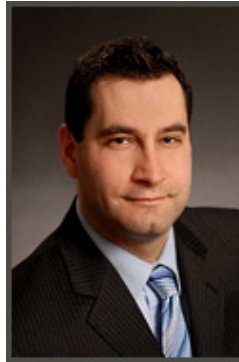
your business to your successor(s), we recommend consulting with your accountant, lawyer, and any other professional advisor that may be necessary for your particular business, in order to be thoroughly advised.

Review Your Will

After all this planning, don't forget to review your Will. At Tierney Stauffer LLP, we will gladly review your Will with you and discuss more advanced estate planning aimed at maximizing the value of your estate while minimizing the taxes and probate fees.

Planning the succession of your business is not easy so reduce the stress and complexities by seeking proper advice. Don't forget that this is in your own best interests as well as the best interests of your loved ones.

For further information or assistance, please contact Douglas Laughton, Partner, Tierney Stauffer LLP at 613-288-3225 or dlaughton@tslawyers.ca. If you have questions about trusts in general, you can contact us at 613-728-8057 or by e-mail at info@tslawyers.ca.



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EDUCATIONAL BACKGROUND

- University of Ottawa, LL.L., 2007
- University of Ottawa, LL.B., 2005
- Michigan State University, College of Law, J.D., 2005

PRACTICE SUMMARY:

Sébastien joined Tierney Stauffer LLP as an Associate in the Wills, Estates & Trusts Planning & Administrative Practice Group in 2009. His practise focuses on estate planning, will drafting and personal and corporate taxation. Sébastien has experience in resolving disputes with the Canada Revenue Agency (CRA), filing voluntary disclosures, assisting individuals with their tax related issues and tax planning for families and businesses. Sébastien is bilingual and practices in both official languages.

He has spoken at various seminars on estate, trust and tax matters. Sébastien has also appeared on radio and television discussing legal issues. He is a tutor for the Law Society of Upper Canada for the Estate Practice section.