The building blocks of success(ion planning)

Four ways to safeguard your business for generations to come

Many entrepreneurs and business owners avoid succession planning because they think of it as something that will happen far off in the future, or as an indication of the end of their businesses – or even their lives.

Succession planning is less about deciding what to do with the business once you are no longer at the helm, and more about ensuring the business continues to operate smoothly as you transition it to the next stage of its life. Maintaining good relationships with your employees, customers, suppliers and family members during and after the process is critical to the success of your business and your legacy.

While many entrepreneurs spend their lifetimes building their businesses, some take little to no time creating their succession plans. This can result in missing out on important tax advantages. It can be a challenging endeavor, but making sure your succession plan includes a business plan, goals, and details of the transition and tax minimization strategies — will help ensure you address your individual, family and business needs for a smooth and successful transition.

An effective succession plan considers:

- **savings and cash flow for retirement,**
- **providing for survivors after your death,**
- **being fair to all your children and beneficiaries, and**
- **preserving the value of the business.**

To begin, you need to understand what a successful succession plan should include so you can protect yourself and your family. Here are the top four places to start:

Drafting a shareholder/partnership agreement

Companies with two or more owners benefit from having a shareholder or partnership agreement that formally outlines the roles and responsibilities of each owner with respect to the company's operations. In addition, the shareholder agreement states what will happen when a partner wants to sell his/her share, or experiences a major life change. This process helps everyone understand and agree on the outcomes for all partners or shareholders when an unforeseen situation does occur.

For example, a formal agreement helps outline how you will handle:

- dividing equity among the shareholders,
- compensation,
- dividend policies and profit distribution,
- ownership buyouts,
- partners disagreement,
- divorce,
- incapacity,
- retirement or death of a shareholder,
- valuating shares,
- payment schedule,
- life insurance requirements,
- pre-emptive rights,
- right of first refusal,
- financing options,
- decision making, and
- exit strategies.

Creating a family trust

Establishing a family trust to take advantage of tax planning opportunities, is just one of the reasons more and more Canadians realize that having a family trust isn't just for the rich anymore. For five years starting in 2009, the number of trusts Canadians created increased 2 percent every year, reaching the highest number in 2013, at 228,940[1] (primarily testamentary and personal) trusts[2].

Family trusts provide many benefits, including:

- maintaining control over your assets,
- safeguarding your assets from creditor claims,
- flexibility as to when and how much you distribute to your beneficiaries,
- giving trustees control to disperse funds to children or other beneficiaries at a time when they are financially mature,
- passing the continued growth on to your beneficiaries,
- holding shares in a family-owned company, and
- reducing probate fees.

Implementing an estate freeze

An estate freeze transfers your business' future growth in value to your children or heirs, essentially "freezing" the value on which you will pay taxes at your death. A common way to establish an estate freeze is converting your common shares in the business to preferred shares (on a tax-deferred basis) and giving your children or heirs common shares with a nominal value directly or through a family trust.

If properly structured, you can maintain control of the business, if desired, and take advantage of the capital gains exemption for qualified small business shares – and you may even be able to multiply the use of the capital gains exemption with family members. You can also implement a partial freeze, by keeping some of the common shares and continuing to benefit from the business' future growth. In certain situations, the value of the company may have declined. In this case, you may want to consider refreezing at the lower current value by having your preferred shares exchanged for new preferred shares equal to the current value – which means a lower death tax upon your passing.

Using multiple wills

Business owners should consider the use of multiple wills. A primary will can include assets that require a probate certificate, such as real estate and personal bank accounts. A secondary will includes other assets that do not require a certificate, such as corporate assets. By separating your assets into multiple wills you reduce the amount of probate fees[3] your heirs pay on the assets in the primary will, while the assets in your secondary will transfer without your heirs having to pay any probate fees on them.

In addition, using a secondary will allows you, as the business owner, to outline who you want to take over the business and how you want the transition to take place. It is also important to plan for a Continuing Power of Attorney for Property and/or Personal Care, so you can choose who will lead the business in your place, in the event you become incapacitated.

If you don't have a shareholder or partnership agreement in place, you could subject yourself, your family, co-owners and employees to have to react quickly in the face of adversity. This situation, which is costly and stressful, can be largely avoided by planning in advance, and putting agreements into place that plan for all the "what-ifs". No one likes to plan for a rainy day, but better to do it now when you and your co-owners are well and getting along, than struggle through it at the time of an unfortunate event.

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1 http://www.cra-arc.gc.ca/gncy/stts/t3/2009-2013/table01-eng.pdf
2 http://www.cra-arc.gc.ca/gncy/stts/t3/2009-2013/table05-eng.pdf
3 Subject to province's probate fees

If you or your company are at the stage where you are considering one or more of these succession planning building blocks to help protect and preserve your wealth, contact your Zeifmans advisor, Ezra Lauterpacht, CPA, CA, Partner el@zeifmans.ca, or Steven Metallo, CPA, CA, Partner sms@zeifmans.ca.

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