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Guest Columnist

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Keeping the family business in the family?

Editor's Note: This is the first of a two-part series on business succession. The second part will run Jan. 5.

IF YOU ARE in business, you are going to leave your business at some point by selling, retiring or being forced out by disability or death. If you do not have a succession plan or make decisions and implement a plan, decisions will be made for you and they might not be what you wanted to happen.

Oh, and you will almost certainly pay significantly more tax.

The succession planning process for your business starts with determining what you want to happen, no matter what, then arranging your financial affairs accordingly, in a tax-effective manner. An additional benefit to going through this planning process is that tax-planning opportunities that benefit you now are often uncovered. So how do you get started? In today's financial world, few can go through the maze without help, and the business succession planning process is no exception. Your certified financial planner and chartered accountant are equipped to take lead roles in the planning process.

Need an adviser? The Institute of Chartered Accountants maintains a database of Chartered Accountants (<http://www.cica.ca>) and the Financial Planners Standards Council maintains a database of licensed financial planners (<http://www.cfp-ca.org>).

Every business and personal planning situation is different. Every succession plan is also different. It is therefore important to thoroughly understand your situation and your objectives before rushing into a solution - be wary of "cookie-cutter" packaged solutions. Taking the time to think through these six key steps will help start your business succession plan on the right track:

1. Assess your current situation.
2. Understand your goals for your business and family.
3. Identify and prioritize your action plans.
4. Select your best action plan and set a timetable.
5. Document your decisions.
6. Implement and monitor your plan.

Assessing your current situation is the first step. What is the value of your business? What would you pay for it? What would you sell it for? If you were to sell the business today, what steps would be required to maintain profitability? Special skills needed to run the business? Relationships with suppliers? Relationships with customers? Lines of credit? Your CA, along with your CFP should be able to help you with this step. Later in the planning process you will require the services of your lawyer and may also require the services of a chartered business valuator and other professionals.

Understanding your personal goals and the goals for your business and family is arguably the most important part of the entire planning process. You are planning a new stage of your life, so it is important to take the time to revisit your life goals and ask yourself some questions.

What does a successful retirement mean? What are you retiring to? What do you want to do with the rest of your life? What are your hobbies? Where do you want to live? What do you want your legacy to be? In short, plan your life, your lifestyle.

Today, there are more resources to assist than ever before, with planning information available at human resources departments and libraries, and from financial and lifestyle planners. Once you have determined your lifestyle objectives, your CFP will be able to help you calculate your funding needs and work with your CA and lawyer to align your succession plan accordingly.

What business succession plan will be best for you and your family will depend on the business decisions you make involving family members. Be aware that doing what is "best for the business" without family discussion and involvement can put a serious strain on your family relations.

Other matters that need to be considered include a long-term vision for business. Can you fund your retirement lifestyle and take your business to the next generation? How do you want to distribute ownership? Should part of the business be liquidated?

If kept in the family, which child? If one child receives ownership in the business, what assets will your other children receive? What is fair? Do your children want to join the business? Children have the necessary skills? Maintain ownership with an outside manager? Sell to employees? Control to spouse? How much control after you have retired? What do you want to happen if you die or get disabled while involved in the business? Does your business qualify for the Enhanced Capital Gains Exemption? If not, are there any adjustments you can make to your corporate structure to qualify?

There seem to be so many questions that many business owners feel overwhelmed and put off starting the planning process.

There is a solution. You can crystallize your business and personal financial goals through a discovery process with questionnaires available through a certified financial planner or CA. Then, with a preliminary analysis identifying problem areas or opportunities, you are better equipped to identify, prioritize and select your best action plan - the focus of next week's article.

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Guest Columnist

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Take time to find best business succession plan

Editor's Note: This is the second of a two-part series on business succession.

After crystallizing your personal goals, desired lifestyle, retirement plans and options for distributing your wealth, it's time to create a timetable for how and when the changes should take place.

Working with a certified financial planner and a chartered accountant, you can determine which of the following business succession options is right for you. The options include:

- Sell your business as a going concern.
- Close up, sell the assets and cash out.
- Merge with a competitor.
- Transition business to next generation.
- Retain family ownership and hire an outside manager.

Which option or combination of options is right for you? Unfortunately, there is no "perfect" plan to accomplish your objectives, only the one that is best for you and your situation. Taking the time to plan, creating tax efficiencies and having a risk management strategy are critical and could actually mean more to your family than the financial gains of the last 10 years.

Of course, the earlier you start the planning process, the more likely you will be able to take advantage of potential tax savings and make a choice that appeals to you. **The importance of waiting to consult with your advisers prior to taking action cannot be overstated.**

A recent example underscores the point. The names of the family members described have been changed to protect confidentiality, but their circumstances are real.

A couple, George and Margo Green, are shareholders in a \$3-million business (OpCo) that is still growing. OpCo has no long-term debt, retained earnings of \$2 million, \$300,000 cash and \$500,000 of investments. George and Margo would like to transfer future growth in the business to family members, while maintaining control. Their daughter, Susan, is working in the business and would like to take it over. A family discussion has confirmed that their son, Bill, is not interested in being actively involved in the business at this point. The couple wants to treat Bill and Susan fairly.

The couple have RRSPs, investments and other assets outside of OpCo, but their preliminary analysis indicates that they will require some cash flow from the assets of OpCo to supplement their desired retirement lifestyle. The total tax bill if all assets were disposed of today with no planning is estimated to be \$1,050,000.

What is the best way for them to fund their retirement lifestyle, transition the business to Susan, offer a fair distribution to Bill and minimize the taxes?

One possible scenario that demonstrates a variety of succession options:

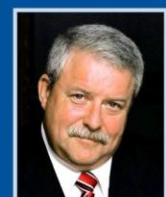
1. Establish a new holding company (Holdco).

2. Transfer sufficient non-active business assets to Holdco (excess cash, investments, etc.) to reduce the total non-active business assets to no more than 10 per cent of OpCo's total asset value.
 - Purifying the company by reducing non-active business assets may permit the shares of the business to qualify for the enhanced capital gains exemption. This could reduce the total potential tax bill by about \$125,000 for each shareholder, in this case \$250,000.
3. OpCo issues a new class of voting preferred shares representing the value of the company - owned by Holdco.
 - This technique is called an estate freeze, since the value of the company is transferred from the common shares and frozen in fixed-value preferred shares. The future growth is transferred to new common shares. If the business qualifies for the enhanced capital gains exemption, the reduction in the tax liability could be locked in, or crystallized. A preferred share redemption program and/or dividends could be used to supplement the parents' retirement lifestyle. A proper redemption program can also help reduce future estate taxes. George and Margo will effectively maintain control through the voting preferred shares.
4. Establish a family trust.
 - A family trust provides potential income splitting and tax savings opportunities while George and Margo maintain control over the assets. This structure also permits flexibility for future planning should their objectives and business succession plans change. In addition, a trust allows for some creditor protection.
5. OpCo and Holdco issue new common shares for nominal value - owned by the family trust.
 - The future growth in OpCo and Holdco is transferred to the next generation while having the possibility of George and Margo receiving dividends from OpCo if their other assets are not sufficient for retirement.
6. Apply for insurance on the lives of George and Margo sufficient to pay a tax bill of \$400,000 each.
 - Life insurance is the most cost-effective way to create cash at death to pay their tax bills. While the primary purpose of life insurance is to create cash at death, owning the life insurance will also make available other planning opportunities. This would also be an appropriate time to do an overall risk assessment and make any necessary adjustments to their entire insurance portfolio.
7. Investment analysis.
 - It is wise to have an investment portfolio that reflects your risk profile, is diversified, provides the required income or growth and is tax-effective. However when you are retired or about to retire, the portfolio mix is obviously even more important
8. Update wills and buy-sell agreements, to ensure that their objectives are reflected and structured to minimize taxation.

Action plans like the one prepared for George and Margo can meet a client's key objectives and provide some flexibility for the future. As objectives change, the plan should be reviewed and updated.

Business succession planning can seem overwhelming and very technical. The most difficult part of the process, though, is determining your objectives. Once determined, your advisers can work with you to design a plan tailored to your needs.

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