

## Benefits of Succession Planning

By: Brett Lemcke-Evans

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How would you feel if:

- your business or your family cottage had to be sold to pay for death taxes;
- you had to pay hundreds of thousands of dollars in taxes that could have been deferred for another 50 years;
- your child's former spouse received half of their inheritance;
- you missed an opportunity to protect your wealth from creditors;
- you had to pay thousands of dollars in probate fees; or
- you missed an opportunity to multiply the capital gains exemption with your entire family saving millions in taxes.

Many business owners put off succession planning because they believe they are too young, don't think their business is successful enough, or assume it is a lengthy, overwhelming process that may involve significant professional fees. Don't view succession planning like writing a will, it is a plan for the future and is critical for a company's long-term success. Your plan may be to have your son or daughter take over the business, or transfer the business to a key employee through a Management Buyout. But you may be caught off-guard by a sudden staff departure, or unforeseen death of a key shareholder, leaving the business disoriented and scrambling to continue operations. Not to mention there may be significant taxes and probate fees owing, all of which could have been avoided or reduced. That is why you need a plan, now.

There are many benefits of succession planning, including:

- Smoothing the transition and continuity of your business;
- Maximizing value at exit;
- Minimizing and deferring taxes;
- Multiplying the capital gains exemption;
- Reducing probate fees;
- Protecting yourself and family from creditors;
- Providing financial security for you and your family;
- Preserving family and inter-generational wealth;
- Clarifying future roles and responsibilities; and
- Inspiring confidence in key stakeholders, family members, employees, customers, and suppliers.

There are various tools and methods involved in successfully implementing a succession plan. These include estate freezes, family trusts, utilization of a holding corporations and proper restructuring to fit your specific needs. It is also important to plan who will be taking over the business, and their roles and responsibilities.

### Future of the Company

To smooth the transition and continuity of the business it is important to determine who will be carrying on. Will it be your children? A niece or nephew? A key employee? It is important to pinpoint which candidates can step into your shoes one day and what you can do, starting now, to help them prepare for the eventual transition.

### Estate Freeze

An estate freeze is a very common succession planning technique. It allows shareholders to freeze the value of the company and transfer the future growth in value to the next generation. To implement a typical estate freeze, the freezer exchanges their common shares (growth shares) for preference shares (fixed value shares) and the children subscribe for newly issued common shares (growth shares). There are different variations of the above strategy (including changing voting control, use of a family trust, partial

freezes, etc.) Among other benefits, this strategy allows a family to defer taxes on the increase in value of the company and if the company is ever sold, you can benefit from multiple capital gains exemptions, which could save a significant amount of personal taxes.

### **Family Trust**

A discretionary family trust is another valuable tool used in succession planning. To setup a family trust, a person, referred to as a settlor, transfers property to the trustees to be held for the beneficiaries. The trustees have authority to allocate income or capital to the beneficiaries, and a discretionary trust allow the trustees to allocate income or capital to any beneficiary, however they wish (i.e. equally between all beneficiaries, 100% to one beneficiary, or any other desired allocation). The beneficiaries of a family trust can also include yourself, your spouse, future children, corporations, future corporations, or even future trusts. Due to the ultimate flexibility this provides, it becomes especially important for family law protection and allows you to maintain control of how the wealth is distributed through out the family. It also helps reduce probate fees and taxes upon death and can be used in combination with an estate freeze, by having the family trust be the common share holder. Another advantage, which may be the most important, is the multiplication of the lifetime capital gains exemption. If you are the sole shareholder of shares that qualify for the capital gains exemption, upon the disposition of your business (i.e. upon death, or to an external investor) you have access to only one capital gains exemption. If these shares were instead held by a discretionary family trust, the capital gain on the eventual disposition of the business can be sheltered by each individual beneficiary's capital gains exemption, potentially saving your family millions in taxes.

### **Utilization of a Holding Company**

A holding company is another tool that is used by business owners to accumulate wealth, while still allowing the operating company to maintain its active business status for the purposes of the capital gains exemption. The operating company can pay dividends to the holding company tax-free if they have more than 10% voting control of the operating company, or the operating company is controlled by a related person. Since the holding company is separate legal entity, it provides protection from creditors attacking the operating company. The holding company is also a valuable tax planning tool for multiple unrelated shareholders. Since each shareholder has different lifestyles, family dynamics, and personal cash requirements, a holding company allows shareholders to invest, distribute funds personally and manage assets without the involvement of the other operating company shareholders.

## **Bottom Line**

Of course, everyone wants to save money in taxes, a major component of succession planning; but to ensure a family's long term success it is pivotal to have a proper plan in place to carry on the business and ensure it is properly structured for the future. Maybe even more important than that is to be proactive and begin planning now.

## **About the Author**

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Brett is a Tax Manager at I&A Professional Corporation. He strives to produce high quality work and is committed to delivering the highest level of client service through his work in accounting, assurance and tax.

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To assist clients who are considering transition to make

...the **right** decision at  
...the **right** time for  
...the **right** reasons™

by providing experience-based knowledge

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