Planning for major life transitions

Business succession planning

Business owners need to be empowered to make informed decisions throughout the process of a sale or transition to the next generation for a successful transition to take place. The new owner can be a family member, third party or key employee(s).

Proper planning can help ensure that the business will continue to operate when the business owner retires, allowing them to sell the business or transition it to family members.

Why create a business succession plan?

Survival of the business: It is important to identify key successors, as they will preserve the company's legacy, but also drive future growth.

In identifying the successor, the business owner will need to look at the future goals of the business and if they want to maintain family ownership, transition to key employees or look for an external buyer. If the business owner wants the family to take over the business, it will be extremely important to have those discussions with their children and potentially grandchildren. There may be some family members involved in the business while others are not. It is important to ensure family harmony by transitioning the business in a fair way.

Maximizing family wealth: It will be crucial to work with a lawyer and accountant to ensure the business owner is maximizing their wealth and minimizing taxes on the transfer or sale. There are a number of strategies that can be implemented when clients seek advice early.

Maintaining family harmony: Identify potential successors based on skills and conversation. It is also important to recognize that treating family members fairly doesn't always mean equally. Perhaps some family members receive ownership shares while other family members receive financial compensation. It can also be helpful to allow the next generation to take on increasing responsibilities for a smoother transition.

Tax planning considerations

Asset or share sale?

When selling the business, the business owner must decide how to structure the transaction, as either an asset sale or share sale. Each method has distinct implications for the buyer and the seller.

In an asset sale, the purchaser buys specific assets and liabilities of a business rather than the company itself. The purchaser typically prefers this type of sale because they select which particular assets they would like to purchase (such as equipment, inventory, etc.). The seller retains ownership of the legal entity and assets and liabilities not acquired. This can be seen as a better option for buyers because of the flexibility it offers.

In a share sale, the buyer acquires ownership of the company by purchasing its shares. The buyer assumes control of the entire business. Sellers prefer this type of sale as they can transfer the entire business and potential liabilities to the buyer.

Lifetime capital gains exemption (LCGE)

This could apply to business owners selling their company through a share sale. The LCGE is a key component for sellers of qualified small business corporation shares, but it does not apply to asset sales.

The LCGE can provide significant tax relief for individual shareholders, not corporations.

To qualify for the LCGE, a business must meet certain conditions:

1. The shares must be shares of a qualified small business corporation;
2. The shares must have been held by the shareholder for at least 24 months leading up to the sale;
3. At least 50% of the business assets must have been active business assets during that two-year period; and
4. On the date of the sale, 90% of the assets must be active business assets.

For business owners in a situation where a prospective share sale is not eligible for the LCGE, because it does not meet the 90% test, they may be able to restructure assets through a “purification” process to eliminate some of the passive assets. Business owners will want to work closely with their tax advisors to ensure this is done properly.

Estate freeze

An estate freeze is a financial and tax-planning strategy used primarily by business owners or individuals with appreciating assets. Its purpose is to lock in the current value of an asset, so that any future appreciation is attributed to new shares or ownership interests, typically transferred to heirs or a trust.

The owner converts common shares into preferred shares, which are valued at the current level. This “freezes” the value of the owner’s interest in the business. New common shares, which will capture any future growth in the business’s value, are then issued to family members or held within a trust. This ensures that subsequent appreciation benefits the new owners rather than the original owner.

By freezing the current value, the owner limits the taxable capital gains that will accrue upon death or sale. Future growth is taxed in the hands of the next generation, who may be in a lower tax bracket. An estate freeze facilitates a smooth transition of wealth by shifting future growth to heirs, while allowing the original owner to maintain control during their lifetime.

Overall, an estate freeze is a valuable tool for succession planning and can help manage the tax burden associated with the transfer of a business or valuable assets.

Business succession planning checklist

Start early

- [ ] Begin the succession planning process well before retirement.
- [ ] Engage family members, key employees, financial, legal and tax advisors.
- [ ] Ensure all stakeholders are aligned and informed throughout the process.
- [ ] Decide if it's important to maintain family ownership, transition to key employee(s) or sell to an external buyer.

Ensure family harmony

- [ ] Have open discussions with family members about their interest and capabilities.
- [ ] Consider different forms of compensation (such as ownership shares, financial compensation).
- [ ] Gradually increase responsibilities for the next generation to ensure a smooth transition.
- [ ] Maintain transparent communication.
- [ ] Define clear roles and expectations.
- [ ] Formalize decisions with legal documents (e.g., shareholder or family agreements).

Maximize family wealth and minimize taxes

- [ ] Work with a lawyer and accountant to explore wealth maximization strategies.
- [ ] Understand and utilize the lifetime capital gains exemption (LCGE), if applicable.
- [ ] Decide between an asset sale and a share sale.
- [ ] Ensure the chosen structure aligns with financial and legal goals.

Regularly review and update the plan

- [ ] Revisit the succession plan periodically to ensure it remains relevant and effective.
- [ ] Adjust the plan as business conditions, family dynamics and personal goals change.

By following these steps, an individual can make a strong and effective business succession plan that will keep their business going and growing. It will help to ensure family harmony and have the best financial outcomes.

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