Toronto Law Journal

Family Business Planning

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Asset Protection

Lessening the possibility of family conflict when faced with family business succession planning can start with proper communication. An individual who is able to clearly communicate relevant intentions with respect to a family business to business partners and family members can assist in preventing conflict in this regard. Business owners may also wish to consider a number of strategies to facilitate business succession to limit any disruption in the business that may result from their retirement, incapacity, or death.

Insurance is the most common tool in asset protection planning in Canada. Life and/or disability insurance can be used to satisfy the liabilities (including tax liabilities) of a business in the event of the incapacity or death of a business owner in a way that facilitates the succession of a business.

Inattention to asset protection planning as part of the estate planning process may frustrate a succession plan. If the tax liabilities on the deemed disposition of the business interest exceed the liquid assets available to an estate, the succession of the business may not be possible, and its dissolution may be required.

A number of factors — such as whether there is an intention for the owner's interest to be bought out in the event of his or her death, whether insurance is intended to benefit beneficiaries who are not receiving an interest in the business (and who may wish to otherwise challenge the gift of the company that has the effect of disinheriting them), and whether additional paid help will be required by the business following incapacity or death — should be considered in determining the extent of insurance required.

A number of options exist with respect to the structure of a disability or life insurance policy intended to protect the assets of a business. Any of the surviving family members, the deceased's estate, the company itself, or a surviving shareholder can be the beneficiaries of such a policy. The insurance policy can be owned by the business owner or by the corporation itself.

Succession Planning

At the very minimum, the individual managing a business should create an alternative signing authority on their business accounts in order to prevent barriers restricting the activities of the business in case of emergency. Using the example of a law firm, the managing partner should provide a licensed lawyer or paralegal signing authority for the firm's bank accounts, including its trust account, in order to ensure that client and firm resources are not rendered inaccessible by the unexpected absence of the partner. It is important to keep clear records and files in order to make the transition easier in the case of emergency or planned succession.

With smaller businesses, one of the easiest ways to pass the business on is by orchestrating a buy-out between the incoming owner and the original owner. A buy-out that is planned over an extended period of time may have fewer tax consequences than an immediate buy-out. The use of a promissory note payable over a number of years may also assist in limiting the taxable capital gain resulting from the sale of a business in a given year.

If the family business is a partnership, the most common mechanism for succession is in accordance with the terms of a partnership agreement, which specifies how the division of the business will be conducted upon the dissolution of the partnership or the retirement, incapacity or death of one partner. If the business is operated through a corporation, a shareholders' agreement may accomplish the same objectives. Where no such agreement exists, the terms of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (or provincial equivalents) and provincial partnership legislation may apply instead.

An "estate freeze" is another option with respect to the transfer of corporate business interests to family members or the future sale of a business. Estate freezes can assist in transferring future increases in value of a business to family members, who will receive the business interest. While estate freezes can be complex and expensive, they can be utilized to facilitate business succession and avoid the issue of insufficient funds for the next generation to purchase the interest, while spreading tax liability on the disposition of the business over several years.

Inattention to one's business succession plan may result in unintended consequences, such as the failure of the business during a time when no one is authorised to effectively manage it, or the sale of the family business if liquid assets are required.

Transfer of Partial Interest

In terms of valuing interests in companies, the rights associated with different classes of shares and different proportions of shares differ and, accordingly, the value of any given share in a company may not be the same as others in respect of which the shareholder can exert more control. The fair market value of a minority interest in a corporation in Canada, even when considered on a pro-rata basis, is worth less than the same number of shares that are part of a majority interest.

The term "minority discount" is used to refer to the difference between the fair market value of shares and their pro-rata value. The reduced market value results from the inability of a minority shareholder to unilaterally elect the majority of directors, to direct the payment of dividends, and to make most major decisions affecting the corporation.

Conclusion

The importance of planning for family business succession should not be underestimated. Legal, tax and financial advisors play a key role in ensuring the smooth transition, sale and/or windup of a family business, and should be consulted as part of a global estate plan.