CLU ADVANCED LEARNING SERIES

CASE STUDY: BUSINESS SUCCESSION PLANNING

Advocis

Case Study: Business Succession Planning

Learning Objective

- Identify relevant estate planning objectives and considerations important to the shareholders of a private business.
- Align and explain retirement and estate planning strategies that address business owners’ planning objectives.

Case Study: Business Succession Planning

Question 1

Explain four recommendations you would put forward to Hank that will help him meet his estate, financial planning and tax objectives in relation to his business, without negating another objective.

Case Study: Business Succession Planning

Question 1 Solution

- First, Hank could incorporate an operating company to run Hank's Haulage. He would be the sole shareholder of the new company.
- Next, he should transfer ownership of all of the business assets from himself to the newly incorporated company. This should be done on a rollover basis (at ACB or UCC), using a section 85 tax-deferred rollover. In this way he can transfer the assets (which do not currently qualify for the LCGE) without triggering capital gains or recapture of CCA. This would allow Hank to transfer the business assets into the newly incorporated company without causing any immediate tax consequences that would otherwise apply.

Case Study: Business Succession Planning

Question 1 Solution

- By implementing an estate freeze of his common shares, Hank could accomplish four things:
  - Transfer all future growth in the value of the business to Brent and Karen, who have a desire to operate the business after Hank's retirement and who are currently important contributors to the ongoing business operations.
  - It would enable him to structure the transaction in a way that could provide a retirement income via dividends on preferred shares of the holding company from the freeze.
  - He could crystallize his available capital gains exemption. This effectively embeds the CGE amount selected into the adjusted cost base of his freeze shares, lowering the capital gain arising on the future disposition of the freeze shares.
  - It limits the amount of taxable income he would have to report at the time of his death, in respect of the freeze shares.

Case Study: Business Succession Planning

Question 1 Solution

- Since only two of Hank's children are involved in the operation of the business, he will need to consider how he will want to achieve estate equalization for LeeAnne, either with alternative estate assets and/or a newly acquired life insurance policy. Taxes at death will likewise have to be provided for.
- Other responses may include an insured shareholder agreement or implementation of a systematic redemption strategy.

Case Study: Business Succession Planning

Question 2

Briefly explain to Hank four different ways that inter vivos trusts could be employed, now or in the near future, to help him to achieve his estate and financial planning objectives. Include, where appropriate, a short discussion of the income tax ramifications of setting up and operating the various trusts.

Case Study: Business Succession Planning

Question 2 Solution

- Come age 65, Hank might want to consider setting up an alter ego trust and transferring at least some of his non-registered assets (particularly any preferred holding company shares arising from the freeze) to the trust. Hank could still be the income beneficiary for the trust (and its assets) but the assets would not form part of his estate at his death, thereby avoiding probate fees on hundreds of thousands of dollars of assets.
- For Irene, he might want to consider setting up a Henson Trust, to provide her with support that would not interfere with her government benefits.
- Also, or alternatively, he might consider setting up an RDSP for Irene.

Case Study: Business Succession Planning

Question 2 Solution

- Hank could consider setting up a charitable remainder trust for the benefit of the community association and settling preferred shares of the holding company from the estate freeze on the trust. He could still retain the income from the shares during his lifetime and could get a current charitable donation receipt for the discounted resent value of the gift that would pass to the charity at the time of his death. Note, however, his estate is reasonably modest and the cost of setting up a trust and redirecting the funds could preclude Hank from addressing other estate objectives in respect of his children and grandchildren.

Case Study: Business Succession Planning

Question 3

Outline four recommendations that you would put forward to Hank to help meet his will planning objectives.

Case Study: Business Succession Planning

Question 3 Solution

- Obviously, Hank needs to update his will since his estate plan may involve an estate freeze that does not anticipate all three children. Depending on whether he purchases additional insurance, and how it is held, the asset distribution will need to be revisited.
- As well, once Hank marries Marge a new will is required, since marriage voids pre-existing wills in many jurisdictions in Canada.
- He would want to change the “per capita” distribution to “per stirpes”, so that LeeAnne’s children would not be disinherited if she were to predecease Hank.
- The will may require a hotchpot clause to take into consideration any reorganization planning with respect to the business assets that Brent and Karen may receive as a result of the estate freeze.
- The will requires a new executor, and perhaps an alternate.

Case Study: Business Succession Planning

Question 3 Solution

- Hank could consider setting up a testamentary spousal trust for Marge, to provide for her during her lifetime should Hank die first; however, this needs to be balanced with Brent and Karen's interest in the business, given that they are the primary resources carrying the business. The trust could also guarantee that the bulk of the estate would be left for his children when Marge dies but, again, this needs to be carefully balanced against Brent and Karen's interests during the lifetime of the new spouse.
- As part of the process of setting up the trust for Marge, Hank should look into initiating a prenuptial agreement with her, setting out her entitlements, so that any rights under provincial matrimonial property and dependents' relief legislation do not interfere with Hank's estate plan.
- He should be cautious about including a clause to disinherit Claude on religious grounds: this could be struck down as being against public policy.