Estate planning strategies for small business owners

Estate planning can be especially critical for small business owners, as the majority of your family's assets and income sources may be tied up in the business. Estate plans for small business owners can be complex. To be effective, they generally need to address your personal, family and business situations and meet the often-conflicting needs of a number of people with a stake in the business. Non-tax issues, such as keeping the business in the family and treating all children fairly, may be more important to you than tax issues.

Among personal factors that need to be considered when developing an estate plan are your age and health, the level of debt and assets you have (both inside and outside the business) and your risk tolerance and retirement plans. Also relevant are income needs, the age of any children, and the degree to which your spouse or other family members may be involved with the business — or hope to be one day. The stage of the business — whether it's a start-up, well established or currently expanding — will also have a major impact, as will how the business depends on you.

Objectives in small business estate plans typically include saving for retirement, providing for survivors after death, being fair to all children, minimizing taxes, providing adequate liquidity and preserving the value of the business upon your death.

Below is a brief outline of some of the estate planning considerations for small business owners, including some strategies and techniques. The comments below usually apply when you are the sole equity owner of the company or are at least in a controlling position.

1. Up-to-date wills and POAs

As with any individual, a small business owner should not wait until middle age to draw up a will. Your death or disability at a young age could effectively cripple the company and might result in severe financial difficulty for the entire family. It is critical that you prepare a will to provide the executors with the power and authority to act appropriately in the event of your death. Unless the will states otherwise, the executor has the obligation to wind up your business within a reasonable period of time. A properly drafted will can give executors some flexibility in holding and operating a business upon your death. This can help the business end up in the right hands and make the transition smooth. It can be set up to use various tax strategies like capital gains exemptions, rollovers and trusts.

Once your will is completed, you should review it regularly, especially any time there is a significant change in the family or business. Similarly, you should consider having valid powers of attorney for your personal financial assets and personal care, which take effect during your lifetime if you can't make decisions for yourself.

2. A competent executor / trustee

The selected executor (there may be more than one) should be familiar with the business, and have the time and expertise to do a good job. It's especially important when there is a small business in the estate that the executor be objective and capable of dealing with potential conflicts of interest among relevant parties. For example, the surviving spouse, active and non-active children, creditors, suppliers, employees and the business (as well as the government) may all have demands for cash and capital. There is growing recognition, however, that an executor cannot be expected to bring a complete

array of expertise in various areas, and as such, the executor should be allowed to hire advisors when needed. The executor retains the ultimate responsibility for the assets and must supervise the management of the assets and the performance of the expert. The fees paid to advisors are generally in addition to the executor's compensation. This should all be addressed in the will.

An impartial third party, such as a trust company, may be more appropriate as one of the executors than a business associate or family member. A business associate may not be able to separate their obligations to the business from their obligations to the estate (creditors and beneficiaries). Family members may be somewhat emotional in their assessment of the business.

3. A survivors' business plan

A survivors' business plan is a written plan that provides direction to survivors. It is not legally binding, nor is it a legal requirement. Such a plan could outline what steps need to be taken to preserve the value of the business if you die or become physically or mentally disabled. It could outline company goals, critical success factors, key employees and an action plan or action items. It could also include a net worth statement that lists assets and liabilities, indicating potential tax liabilities on any accrued gains. Ideally, the plan should be reviewed periodically with family members, executors and other key employees while you are alive. Properly prepared, it may save survivors time and confusion at a stressful point in their lives.

4. Adequate life and disability insurance

Insurance can be used to provide income for the family in the event of your disability or death. It's also useful for generating cash to pay for taxes on large capital gains and other liabilities upon your death. The taxes owing on the death of an individual who has successfully built a company from scratch could be significant and could jeopardize the continuation of the business. An insurance-needs analysis may help estimate the funds required to eliminate liabilities and pay the family's living expenses — present and future. Both term and permanent insurance can be customized to provide liquidity on your death, your spouse's death or both. Insurance needs may be reduced if sufficient non-business assets have been accumulated by the owner.

5. Key person insurance

If the skills of the owner or any other key employee are critical to the success of the business, you may want to consider key person life insurance. Such a policy could provide for sufficient funds to reduce any corporate borrowings for which the key person provided a guarantee, to pay for an executive search or the services of an interim manager, or to otherwise support the business through its transition to a successor without pressure from creditors, suppliers and shareholders.

If the company cannot survive without you or the employee and will be liquidated on your or their death, key person insurance will be of less value but may still help preserve the value of the business. On the other hand, if the company is well established and mature, or has sufficient cash reserves, there may be less need for this type of insurance.

6. Estate freezes

One way to minimize the impact of taxes at death is through the use of an estate freeze while you are alive. An estate freeze allows the future growth in the business to accrue to the next generation, thereby capping the growth on which you will be taxed on death.

One method is for you to convert your common shares to preferred shares (on a tax-deferred basis), with children subscribing for common shares with a nominal value. Alternatively, you could set up a family trust as part of an estate freeze to subscribe for common shares.

The use of a family trust can allow flexibility in the timing and amount of distributions to the beneficiaries and provide for control and management by the trustees, until the children or other intended beneficiaries are financially mature.

However, proposed changes to the taxation of private corporations were released in 2017. These proposals could impact the tax rate on dividends paid to your family members after December 31, 2017 from a corporation which you operate, and could significantly reduce the ability to split income with family members using a private corporation unless they are sufficiently involved in the business. For more information, see the update on the [Canadian-controlled private corporation (CCPC) tax proposals](#).

If the estate freeze is properly structured, you can maintain control, if desired, and take advantage of the capital gains exemption for qualified small business shares. It may also be possible to multiply use of the capital gains exemption with family members.

Similarly, the proposals may impact the tax rate on capital gains realized after 2017 on the disposition of shares received by family members during an estate freeze, unless the family members are sufficiently involved in the business, or the capital gain could be sheltered using the lifetime capital gains exemption (LCGE). Family members can continue to make use of the LCGE on shares they hold in a corporation you operate.

Before you do an estate freeze, you need to be confident there are enough assets and income available to maintain your desired lifestyle until death.

Consult tax and legal experts, as this is a complex succession technique.

7. Discretionary trusts

If you have yet to determine which children will succeed you in the business, your will could put the business interest in trust until the beneficiaries are ready to take control of the company. The trustee could be given discretionary powers to retain appropriate personnel to run the business in the meantime. As well, the trustee could have full power to allocate business and non-business assets among the children at a future date, based on an understanding of your wishes. The trustee could also be given the ultimate authority to wind up or sell the business if it is simply not viable and has become a financial drain on the estate, or if an opportunity arises that is advantageous for the estate.

8. Shareholder / partnership agreements

Where a company or business involves more than one person, a shareholder or partnership agreement is useful to pre-determine what would happen if a certain event, for example, if a key shareholder or partner died, retired, or became disabled or divorced, occurred.

A buy-sell provision, for example, could set out how surviving partners or shareholders would buy out the deceased's share of the business, how the price would be determined and how and when proceeds would be paid. There are 2 benefits of such a clause. First, it creates a mechanism so that surviving partners or shareholders don't have to end up with a spouse or other heir as an unwelcome partner. Second, it provides liquidity from the private shares or partnership interest of the deceased for the benefit of surviving family members. In a family business, a buyout clause could help active children buy the interests of non-active children once one or both parents have died. Life insurance is often used to fund buyouts.

A shareholder agreement and any life insurance used to fund the purchase of shares at death should be reviewed regularly, just like a will. Ideally, you should prepare the shareholder agreement at the same time as the will.

9. Spousal trusts

A testamentary spousal trust (a trust set up under a will for the benefit of a surviving spouse or common-law partner) may be a useful tool to help you provide a surviving spouse with income from the business for their lifetime, with the capital transferring to the children on the surviving spouse's death, if you wish. The will should be drafted carefully so that corporate distributions are allocated in a manner following your intentions. To that end, an executor is often given the power to allocate corporate distributions to income or capital as they decide.

If you made an estate freeze during your lifetime or if you retired from the business and retained preferred shares to provide retirement income, you may want your preferred shares to go into the spousal trust.

10. Leaving non-business assets to non-active children

Children of successful business owners often come to expect a share of the business regardless of whether they are active in the business. However, you may wish to leave the business only to the active children to minimize conflicts if active and non-active children are shareholders. To resolve this issue and equalize benefits, you may decide to leave the controlling interest of the business to the active child or children and leave the non-active child or children non-voting business interests (for example, preferred shares), non-business assets (for example, a house) or life insurance proceeds. The will preparer would need to address valuation issues of the various assets carefully.

11. Separate pools of assets

As a company grows, you may want to establish a pool of funds separate from the company to diversify your holdings so you and your spouse are not overly dependent on the continued success of the business during retirement. This could be done through registered retirement savings plans (RRSPs), tax-free savings accounts (TFSAs), deferred profit sharing plans (DPSPs) and other investment accounts.

You can use a holding company to hold assets. The holding company's assets may be insulated from claims of the operating company's creditors. A holding company can also be part of an estate freeze to hold preferred shares of the operating company or other non-registered investments.

Be aware of the emotional aspects of succession and estate planning and prepare your business and family to deal with the reality of the situation. They should be prepared to determine whether your chosen successors are ready, willing and able to assume roles in the business, or whether the best course of action is to sell the business. Communication is key for business owners who have grown children and wish to equalize benefits, achieve fairness and minimize conflict. In many cases, you should meet with your family to see the level of interest your children have in running the family business and their plans for the business.

Your CIBC advisor can add value by pointing out potential issues and opportunities, and providing you with an integrated picture.

Many of the strategies discussed in this article are sophisticated, and you should consult insurance, tax and legal specialists when you develop and implement an estate plan.

For more information

Talk to a CIBC Advisor at any banking centre | **Call** 1 800 465-CIBC (2422) | **Go to** www.cibc.com

Banking that fits your life.

Disclaimer:

This report is published by CIBC with information that is believed to be accurate at the time of publishing. Banking products and services are provided by CIBC. Investment products and services are offered by CIBC Securities Inc., a wholly-owned subsidiary of CIBC and a member of the Mutual Fund Dealers Association of Canada, or by CIBC Investor Services Inc., a subsidiary of CIBC, a member of the Investment Industry Regulatory Organization of Canada and the Canadian Investor Protection Fund. CIBC and its affiliates and agents are not liable for any errors or omissions. CIBC and its affiliates and agents are not responsible for providing updated or revised information. This article is intended to provide general information only and should not be construed as specific advice suitable for individuals. Since a consideration of individual circumstances and current events is critical, anyone wishing to act on information in this article should consult his/her CIBC Advisor. Certain articles may discuss tax, legal or insurance matters. For advice on your specific circumstances, please consult a tax, legal or insurance professional. Any references in this article to Canadian tax matters are based on federal tax laws only, unless otherwise stated. Provincial tax laws may also apply and may differ from federal tax laws.

CIBC Cube Design & "Banking that fits your life." are trademarks of CIBC.