ADVANCED WEALTH PLANNING GROUP

No Drama: Plan for a Smooth Family Business Succession

WELLINGTON-ALTUS

Succession planning is vital to ensuring the orderly transition of a family business from one generation to the next. Yet family business owners tend to avoid this complex and emotional exercise for many reasons: their identity is too closely tied to the business, they are too busy with day-to-day operations, or they worry that the next generation is ill-prepared to run the business at this time.

Whatever the reason, the lack of consideration to or drafting of a detailed succession plan can result in a family business struggling unnecessarily or even failing when the next generation takes over. Lost revenues, unfavourable tax consequences, missed business opportunities and strained or broken family relationships are just some of the consequences of poor planning.

- **More than 60%** of family enterprises will change ownership in the next decade.
- **78%** of family business owners expect future generations to own the family business.
- **Half** of those business owners are **not confident** ownership will continue.

Family Enterprise Foundation, "Ready, Willing and Interested – or Not? Canadian Family Business Transition Intentions" 2021.

As a business owner, ask yourself:

- Who could take over if you suddenly died or became incapacitated?
- What are your goals and priorities in transitioning the business (i.e., do you want to maximize its value, keep it in the family, use its value to fund your retirement, benefit family members, or continue your involvement or control)?
- What is your timeline for transferring each of the management, ownership, and control functions of the company? Would you prefer a quick or more gradual transition?
- Have you identified your successor(s)? Are they aware of your plans? Do you have a timeline for training your successor and providing them with exposure to all aspects of running the business?
- Do you want to sell or transfer the business to the next generation, key employees or a third-party purchaser?

Think Ahead

While it is never too early to begin the process, a well-defined succession plan should ideally be in place at least two to five years before the owner intends to exit or sell the business.

A business succession plan should:

- clarify who should be prepared to assume responsibility in the event of the owner's unexpected death or incapacity,
- ensure training and exposure is provided to the agreed upon successor(s),
- explore and set up tax planning opportunities,
- outline steps to retain business relationships and maximize the value of the business upon a transfer,
- confirm the ongoing interest and commitment to the business by stakeholders including family members (whether they are involved or not) and key employees, and
- include consultation with trusted tax specialists, lawyers, accountants, and wealth, investment and insurance advisors.

Significant tax savings opportunities may be lost if planning isn't completed at least 24 months prior to a sale.

Key Tax and Estate Planning Tools

The spectre of major tax consequences is one reason for delaying business succession, but taxes are inevitable on a business transfer or sale whenever it occurs – while the owner(s) are alive or upon their death. Owners have several levers that can help to structure the transaction for tax efficiency, including:

1. **The lifetime capital gains exemption (LCGE)**, which shields over $1 million in gains from taxes upon the sale of certain qualifying corporations' shares.
    - Accessing – the corporation must meet certain criteria for active business assets over the 24-month period preceding the sale, and the day of sale, to qualify.
    - Multiplying – it may be possible for others within the family to also access the LCGE provided they are shareholders (and considering any TOSI limitations), reducing the overall tax bill on the sale of the company.
2. **Capital gains reserve.** This mechanism allows you to defer reporting the capital gains on the sale of business shares where proceeds are received over time (generally up to 5 years, or 10 years in some family business transition contexts).
3. **Dividend vs. capital gains.** Business owners tend to prefer the more favourable capital gains treatment on sale, but dividends can also be advantageous in the right circumstances.

Communicate Your Wishes

Once created, your succession plan can be revisited and updated periodically as circumstances change. Your succession plan should:

- **Clearly identify who** will assume control, management, and ownership of the business upon your exit, recognizing that these are all different functions. Detail the training or experience they require.
- **Establish advisory board(s),** implement regular meetings for family and the business – including key employees and owners – and ensure external advisors are in place.
- **Explain** the rationale of the succession plan in family meetings, management and board meetings and when seeking both personal and business tax and legal advice. Reference the strategy in wills, shareholder agreements and any other official estate documents.

Get Good Advice

While the prospect of transitioning your business to the next generation may be daunting, the advantages of considering the issues and creating a plan far outweigh the potential pitfalls. For assistance, please reach out to your Wellington-Altus advisor.