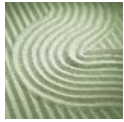
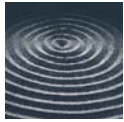
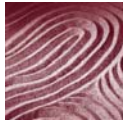


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Business Succession Planning **8th Tax Planning for the Wealthy Family** **Sept. 20, 2010**



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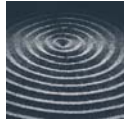
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Topics



1. Objectives of Succession Planning

2. Estate Freeze

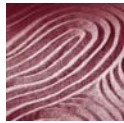


(a) Implementing an Estate Freeze

(b) Share considerations

(c) Current issues

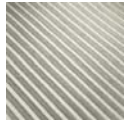
(d) Use of trusts



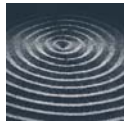
3. Multiplying the Capital Gains Exemption (CGE)

4. Modifying an Estate Freeze: Re-Freezing, Thawing, etc.

5. Shareholders' Agreements



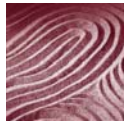
Objectives of Succession Planning



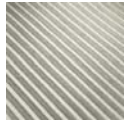
- To limit the tax on an founder's assets on death



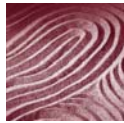
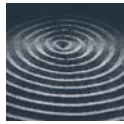
- To fund retirement needs of the founder



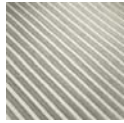
- To transfer wealth to next generation in a tax-effective manner
- To enable income-splitting among family members
- To give effect to non-tax considerations



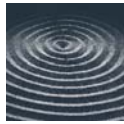
Some non-tax considerations



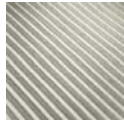
- Transfer control to next generation as determined by the founder
- Provide next generation with “sense of ownership” and involvement in the business
- Provide flexibility for equitable treatment of spouse and next generation
- Can provide for creditor protection



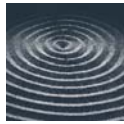
Factors to Consider



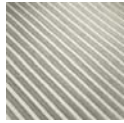
- Age and health of the owner
- Nature and size of the enterprise
- Prospects for future growth of the enterprise
- Current and future market conditions
- Interests of other family members or third parties
- Age and marital status of family members
- Cash flow
- Sufficiency of assets and standard of living
- Other assets and income available to the owner
- Amount of accrued income tax liability
- Exposure to creditors



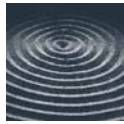
Estate Freezes



- Reorganization of shares in which the value of the common shares of a corporation is “frozen” at their FMV at the date of the freeze
- “Freezor” exchanges common shares for fixed-value preferred shares equal to FMV of corporation at date of freeze
 - Consider using 2 classes of freeze shares, control shares and fixed-value shares
- New common shares to which future growth of enterprise accrues are held by others
 - Consider OBCA amendments re same class of shares



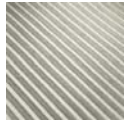
Why Freeze?



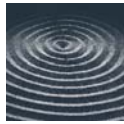
- Limit amount of capital gains tax upon death
- Defer income tax liability until shares disposed of
- Income-splitting arrangements
- Multiply access to Capital Gains Exemption (“CGE”)
- Enable participation in corporation for family members for nominal cost
- Allow growth of corporation to accrue to future generations

But Consider...

- Control
- Sufficiency of assets
- Managing reasonable expectations of the parties

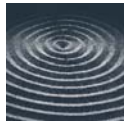
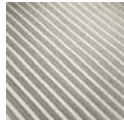


Implementation of Estate Freeze

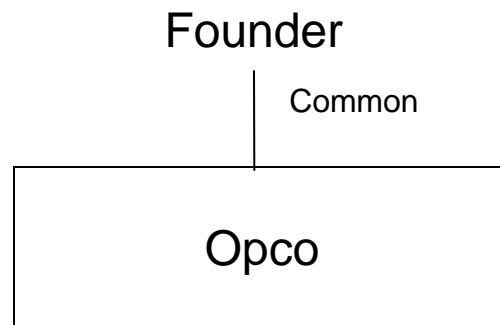


- Variety of ways to implement an estate freeze
 - s. 85 rollover (see IT-291R3, IC 76-19R3)
 - s. 86 share reorganization
 - s. 51 share conversion (IT-96R6)
- Consider using a discretionary family trust (IT-369R, IT-369RSR)
- Entire amount of future growth may be attributed to freeze beneficiaries, or freezor can retain some of the benefit
- Depends on individual facts and circumstances

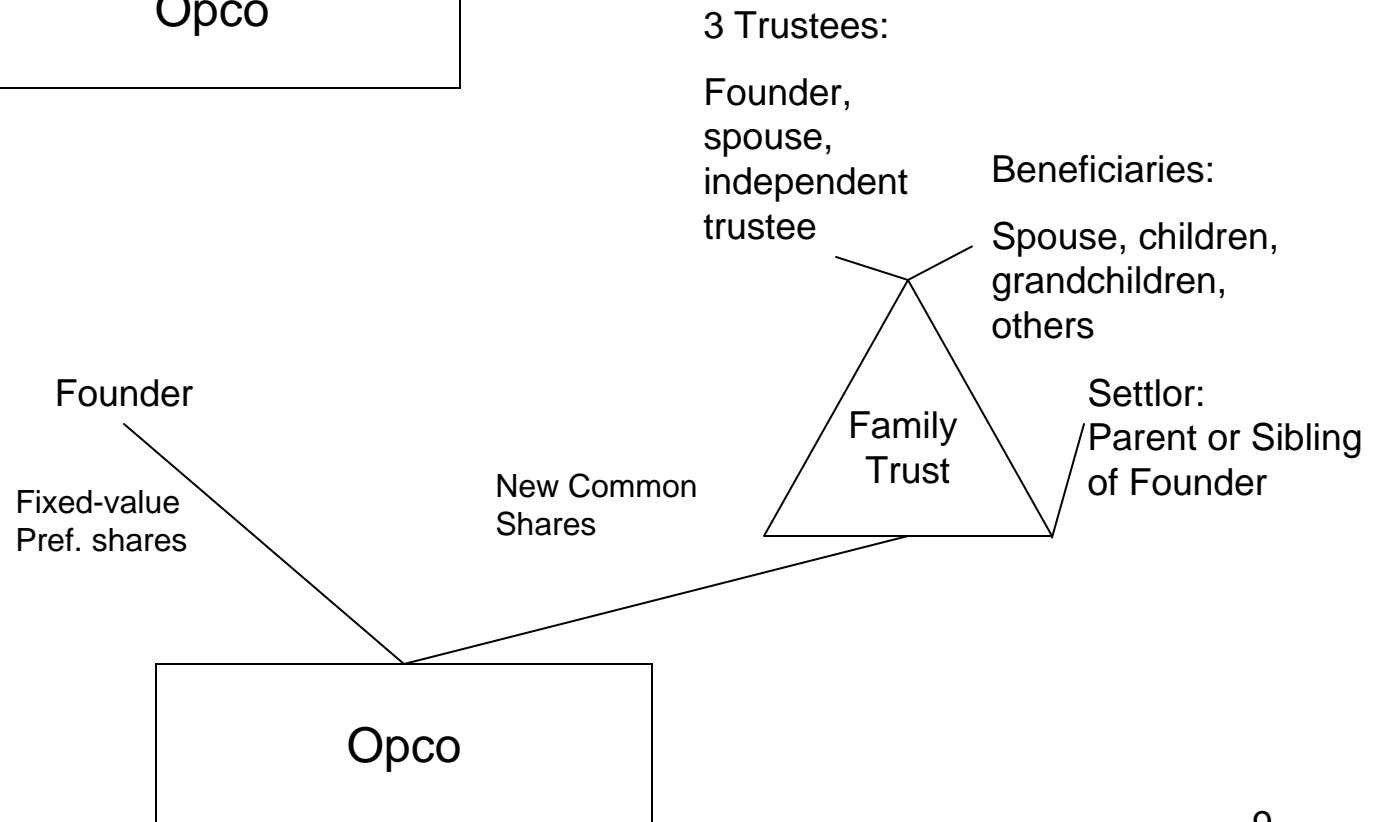
Estate Freeze

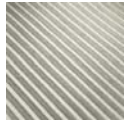


Before

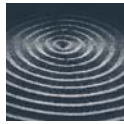


After





Attributes of Freeze Shares

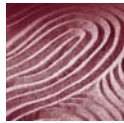


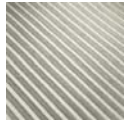
- FMV of freeze shares must be equal to the value of the Old Common Shares (i.e., consideration received)



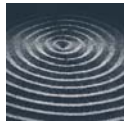
- CRA's position:

- redeemable at the option of the holder
- entitled to a dividend (not exceeding a reasonable amount)
- may or may not have voting rights (but should at least have voting rights on matters involving a change to the rights, conditions or limitations attaching to them sufficient to protect those rights)
- absolute priority on any distribution of the assets of the corporation on a liquidation, dissolution or winding-up

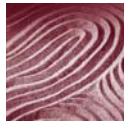


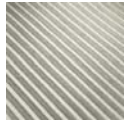


Share Attributes

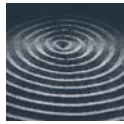


- CRA's position (cont'd)
 - absolute priority re redemption of shares
 - no restrictions on transferability
 - must contain a price adjustment clause for the redemption price
- See CRA Round Table at 1980 CTF Annual Tax Conference, 1981 CTF Annual Tax Conference, and 1993 CTF Annual Tax Conference; and 2008 APFF Annual Conference





Current issues – “skinny shares”



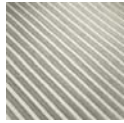
- May issue preferred (value) shares and voting (control) shares in exchange for Old Common Shares



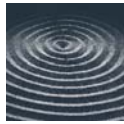
- Previously, CRA had indicated that it does not have an established position on the value of voting non-participating shares



- At 2007 CTF Annual Tax Conference, CRA asked to revisit this issue and confirmed that it still does not have an established policy
 - Referred to IC 89-3 for information on valuation
- But comments of a general nature given:
 - CRA will consider what a hypothetical arm’s-length purchaser would be willing to pay for particular class of shares, and confirmed that, in its opinion, while it is difficult to ascertain what a pure voting right would be worth, a hypothetical purchaser would be willing to pay *some* amount for voting control of the company



“Skinny” shares

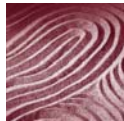


- At October 2009 BC Tax Conference, CRA asked to clarify its response at the 2007 CTF Annual Tax Conference

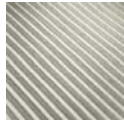


- CRA stated:

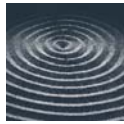
“...non-participating controlling shares have some value and may therefore bear a premium. However, in the context of an estate freeze of a Canadian-controlled private corporation, where the freezor, as part of an estate freeze, keeps controlling non-participating preference shares in order to protect his economic interest in the corporation, the CRA generally accepts not to take into account any premium that could be attributable to such shares for the purposes of subsection 70(5) of the *Income Tax Act* at the freezor’s death



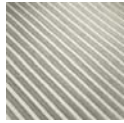
- No formal policy statement to date



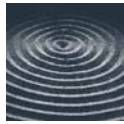
CRA Audits of Family Trusts



- Recent audit activity on “care and maintenance” of family trusts
- Likely arose from use of Alberta trusts
- CRA auditing settlement of trust (settlement funds), implementation documentation for freezes and distributions from family trusts



The Use of Trusts

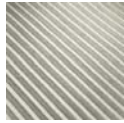


- Discretionary *inter vivos* trust may be utilized to hold New Common Shares to which the future growth of the corporation accrues
- Founder, spouse, children, other trusts and corporations may be beneficiaries
- But, exercise caution when choosing trustees and settlor
 - subs. 75(2) and interaction with 107(4.1)
- Trustees subscribe for New Common Shares using borrowed funds
- Caution re corporate attribution rules – may require special provisions in trust deed

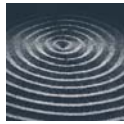


Utilizing the Capital Gains Exemption (CGE)

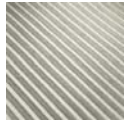
- Individual resident in Canada can shelter up to \$750,000 of capital gain arising on disposition of QSBC Shares
- To be eligible to claim the CGE:
 - corporation whose shares are disposed of (“Opco”) must be a CCPC;
 - at least 90% of Opco’s assets must have been used in carrying on an active business in Canada at the time the capital gain is realized (the “Determination Time”);
 - in the 24 months immediately preceding the Determination Time, the individual or a person or partnership related to the individual must have owned Opco’s shares; and
 - in the 24 months immediately preceding the Determination Time, more than 50% of Opco’s assets must have been used principally in an active business carried on in Canada by Opco or a corporation related to Opco



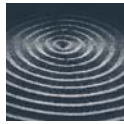
Utilizing the CGE



- Problem of investment (passive) assets held in Opco
 - Certain amount of cash, near-cash investments permitted if used for business purposes
 - Excess investment assets will taint the 50/90 determination
 - Opco will need to be “purified”



Purification of Opco



- Point-in-time purification

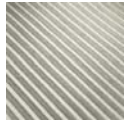
- Use of stock dividend
- S. 86/51 exchange



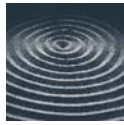
- On-going purification

- Use “bad” assets to pay liabilities, capital dividends, return of capital, salaries/bonuses, etc.
- Use of corporate beneficiary of trust structure
- Redeem freeze shares on on-going basis
 - Redemption amount to be paid with “bad” assets
- Payment of inter-corporate dividends





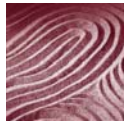
Modifying an Estate Freeze



Why Now?



- Estate freeze presumes increase in value of corporation over time



- Current depressed market an impetus for altering freezes already implemented
- Take advantage of current lower values
- Assuming values increase over time, will produce an even larger minimization of capital gains tax and deferral of tax liability



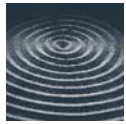
Freeze issues in an economic downturn

Re-Freeze:

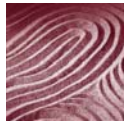
- If initial freeze was at a high value, option to re-freeze at lower amount
- Involves converting the freezer's existing preference shares into a new class of pref shares valued at the current FMV of the corporation
- There was a concern that CRA would take the position that there is a benefit conferred on the common shareholders
 - Recent CRA pronouncements have stated no benefit
- How many times can taxpayer re-freeze?
 - No limit
- Use new trust for new growth shares to “re-set” 21-year rule



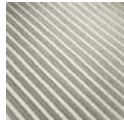
Modifying an Estate Freeze



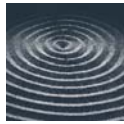
Melt:



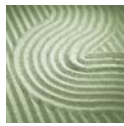
- Arrangement whereby freezor able to access some of the appreciation of the corporation while leaving structure of freeze intact
 - Freezor can be paid a salary or bonus (which can be increased)
 - Can increase amount of dividends declared in favour of freezor
 - Interest on notes taken back by freezor as part of initial freeze can be increased?



Modifying an Estate Freeze



Thaw:



- Transaction undertaken to unwind the previously implemented estate freeze, to put the freezor virtually in the same position as before the estate freeze

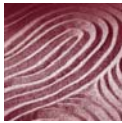
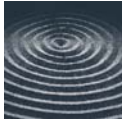
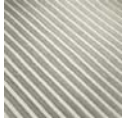


- Growth shares can be reacquired by freezor
- Freeze shares can be converted into common shares
 - May have valuation issues
- A trust may be used to effect a thaw (also called a “gel”)

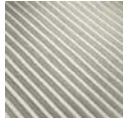


Considerations for Shareholders' Agreements

- Ensure agreement does not impact share value
- Agreement should provide flexibility for related-party reorganizations
- Flexibility re buy-sell provisions on death
- Flexibility for on-going purification

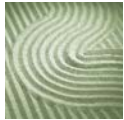
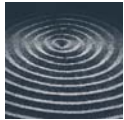


Questions?



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