Private Company Services
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Exit Focus

Life after the deal

Exit Focus Series
Part five of five

The final installment of the series shares advice on how to preserve and transfer the wealth generated by the exit from the business.

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Introduction

As the fifth and final installment of our Exit Focus Series, Preparing for life after the deal discusses how to preserve and transfer the wealth generated by the exit from your business.

Private business owners are accustomed to making 5-year and 10-year plans, and implementing the resulting informed business decisions, yet they often face new territory when the time comes to transfer the value—and, ultimately, control—of their business to others. At this time, planning begins to focus intensively on making informed decisions about one's personal financial future, and business gets personal.

Exiting a business poses unique challenges for private company business owners. First, the exit requires effective transaction planning. Second, the exit converts wealth, which was formerly held as the value in the business, into liquid assets. The wealth must be appropriately structured and managed to meet the goals and needs of the owners, both for their own lifetimes and for future generations.

The same level of careful planning that boosts many private business owners into a comfort zone can help them preserve their post-exit wealth and potentially pass it to future generations. Doing it right requires private business owners to effectively plan for Life after the Deal, as explored in the pages that follow.

Need to talk?

Whatever stage of your transition your company is at, we can help you make the complex decisions that need to be made, understand the process and choose the right option to help you realize the value of your business and achieve your long-term vision.

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Executive summary

Navigating the wealth management maze: building the right foundation

A private company owner should consider effective income tax and wealth transfer planning over the course of a lifetime, but several important questions come to the forefront when exiting a business. *What income tax issues will I now face? Where do my investment, retirement, and wealth transfer plans go from here? Where does insurance fit in?* These and other questions need thoughtful consideration, as some of the first decisions made have far-reaching impacts. Therefore, the owner must begin to put an effective foundation in place for managing the wealth that will follow—even before an exit strategy reaches the closing stage.

The tools of effective wealth preservation and transfer

Appropriate wealth management and transfer planning blends personal, financial, and tax considerations into a comprehensive plan that preserves a family's wealth for both the planning individual and their heirs.

Systematic approaches to wealth management and transfer

Former private company owners need tax-efficient means for preserving wealth and transferring it to successive generations. An appropriate plan—blending personal, financial, and tax considerations into a comprehensive family wealth transfer strategy or business succession plan—preserves a family's wealth for the individual and their heirs. An effective plan will meet your objectives, whether those objectives are to maximize the benefits of ownership and assets; distribute assets to family members or charities; appoint capable estate managers as executors and trustees; minimize taxes, probate, and administrative costs; and/or ensure the liquidity and stability of your estate.

Navigating the wealth management maze: building the right foundation

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A private company owner should consider effective income tax and wealth transfer planning over the course of a lifetime, but several important questions come to the forefront when exiting a business. What income tax issues will I now face? Where do my investment, retirement, and wealth transfer plans go from here? Where does insurance fit in? These and other questions need thoughtful consideration, as some of the first decisions made have far-reaching impacts. Therefore, the owner must begin to put an effective foundation in place for managing the wealth that will follow— even before an exit strategy reaches the closing stage.

Income tax planning around the sale

As indicated in the fourth installment of this series, developing tax strategies early in the selling process is essential.

Although maximizing the sale price of your business is a primary concern, a myriad of sale-related income tax issues should also be addressed early on to maximize after-tax results. Here are a few examples:

Asset or Share Sale

- Selling assets may allow the vendor to keep certain assets, such as land or buildings.
- Selling shares may permit the vendor to implement advantageous tax planning.

Tax planning to defer or lower taxes

- The vendor may claim a capital gains reserve to recognize the sale proceeds over five years in order to defer taxes
- Spreading income over 5 years may allow the vendor to recognize proceeds of sale in years where their graduated tax rate is lower.

Claiming the "Capital Gains Exemption"

- Up to $750,000 of the gain from the sale of qualifying shares of Canadian private corporations may be sheltered from tax.

Timing of gifting to charity

- Gifts to charity may be made in years where income is high, such as in the year of sale, to maximize deductibility.

Assembling the right advisory team for effective wealth management and transfer

While running a business, owners tend to surround themselves with trusted teams of advisors. As the focus turns to managing wealth, a similar approach is wise. Wealth management is a complex endeavour that encompasses many concerns, including:

- Investment and retirement planning
- Estate planning
- Insurance planning
- Asset, cash flow, and debt management
- Income tax planning and compliance
- Educational funding
- Philanthropic planning

An advisory team will serve as a sounding board to assist with strategy, financial considerations, and operational improvement ideas designed to preserve and build value for you and your family.

Developing a strategic investment plan

An effective strategic investment plan will incorporate tax planning and risk management, along with investment strategy and implementation. This plan must be tailored to the individual's financial goals and risk tolerance, and then continuously monitored to ensure it is properly implemented and goals are met. Considerations involved in managing a strategic investment plan include:

- An understanding of the tax consequences associated with investment products recommended by the investor's money manager or based on the tax attributes of the particular portfolio
- Selection and retention of money management firms
- Investment performance reporting on both fund and portfolio bases
- An investment policy that balances long-term needs and risk tolerance
- Implementation of an appropriate asset allocation strategy
- Selection of fund and account managers who are focused on after-tax results and, in some cases, on obtaining reduced investment minimums and management fees
- Ongoing portfolio performance and related adjustments in the investment policy
- Use of an investment holding company or family trust to hold investments

The importance of diversification and asset allocation

Diversification is at the very root of investment planning. One might think diversification is accomplished by simply engaging multiple investment advisors, opening multiple accounts, or investing with a variety of mutual fund companies. In reality it involves much more, including proper asset allocation and the division of the allocation into sizes, styles, and sectors of the market.

It is particularly important that careful consideration be given to diversification of an investment portfolio at the onset of the development of an investment strategy. Likewise, review and follow-up are important to ensuring that investments stay on track.

The goal of asset allocation is to make varied investments that move independently in the market and create a diversified investment base. This diversification can be tailored according to time horizon, risk tolerance, need for liquidity, marketability, and capital appreciation. Asset allocation and diversification can help protect against marketplace volatility, as various sectors of the market will outperform or underperform at different times. It is important to note that diversification will not eliminate risk. Market risk, otherwise known as systemic risk, will always be present when you are investing in the market.

Family issues—yours, mine, and ours

When exiting a business, one of the most profound effects of newly liquid wealth is on family dynamics. A wide range of decisions will be required with respect to lifestyle, to how much of your wealth to give to children and others, to what form you want to give your wealth in, and to the timing of those gifts. You will also want to consider transparency issues within the family: who should know what, and when it should be known.

Family goals and needs should play major roles in most, if not all, of your wealth management and transfer decisions. Your planning may need to manage—and balance—the dynamics of marriages, children, grandchildren, stepchildren, in-laws, and others.

Some of the issues you must consider are:

Prenuptial agreements – These contracts allow prospective couples to resolve potentially divisive financial issues in writing before their marriage. They can be particularly helpful when there are children from prior marriages, an expected inheritance, closely held business interests, or substantial debt and/or wealth on either side. Further, prenuptial agreements should be considered for children who may be receiving a substantial inheritance.

Nontraditional families – If you and your partner are not married, appropriate provisions should be incorporated into all of your financial planning documents—especially those involving estate planning, as intestacy laws can have complex and undesirable consequences.

Special needs – For a special needs child, a special trust known as a "Henson Trust" may be set up during your lifetime or as part of your will that allows the child to receive their inheritance and still be eligible for provincial disability support benefits.

Citizenship and Residency – For family members that may be studying in another country or who choose to relocate to another country (i.e., children moving to the U.S.) there are special tax considerations that should be considered in order to minimize both Canadian and foreign taxes.

Life events requiring review of documents – Effective planning is not a onetime event. As your life, goals, and family circumstances shift, you will need to revisit your documents to be sure they continue to represent your wishes and intentions. Examples of life events that should trigger a review are:

- Marriage/separation/living together
- Birth or adoption of children or grandchildren
- Onset of mental or physical problems in a child
- Tax law changes
- Changes in family law legislation
- Moves to new jurisdiction inside or outside Canada
- Plans to give or sell a business to your children or others
- Purchase or sale of major property
- Care of elderly parents or other relatives
- Death of spouse, child, or parent
- Serious long-term illness

When, how, and how much to gift – This can be one of the greatest challenges of newfound liquid wealth, as there are a number of questions to consider: What is fair versus what is equal? What is too much? What is too young? What is the right timing with respect to both tax and nontax factors? When should I consider trusts to deal with beneficiaries' age or maturity or other factors?

These are just a few of the fundamental issues that inform an effective wealth management and transfer plan, and should be considered well before the exit strategy reaches the closing stage.

The tools of effective wealth preservation and transfer

Wealth transfer planning should be considered over the life of the business, not just post-sale.

Appropriate wealth management and transfer planning blends personal, financial, and tax considerations into a comprehensive plan that preserves a family's wealth for both the planning individual and their heirs.

Income tax planning

Income tax planning focuses on planning to quantify and reduce current and future year federal and provincial income tax liabilities, and can help you reach your personal goals by:

- Determining timing and structure of charitable gifts to maximize donation credits
- Evaluating investment transactions to determine a tax strategy for capital gain/loss recognition
- Revising debt structure to increase the portion of interest expense eligible for current income tax deductions

Wealth transfer planning

Proper wealth transfer planning is an integral part of successful wealth management. When done correctly, wealth transfer planning ensures assets pass to family members, charities, and other intended beneficiaries at the lowest tax cost possible, while retaining desired control. If not properly considered, wealth transfer during your lifetime or as part of your estate plan can tear a family apart, turn children against one another, and ultimately leave inheritances lost to taxation and legal fees.

It is important to remember that wealth transfer planning should be considered over the life of the business, not just post-sale. While point-of-sale value is hopefully at a maximum, the tax costs are also higher.

The primary purpose of estate planning is to ensure that you direct how your assets get distributed. A secondary goal of estate planning is to eliminate or minimize federal and provincial income taxes.

The will: the foundation of your estate plan

The will is a legal document created by an individual, which provides survivors with instructions following the individual's death. This the most basic and essential estate planning tool, yet many people either have no will or have one that is very much out-of-date.

One of the most important effects of a will is avoiding intestacy, which is the situation that results when an individual dies without a will. There is an old but true adage: "If you don't make a will, the state where you live will make one for you," as each province has intestacy laws that determine who gets your property and how much of it.

There are many goals accomplished with a will, including:

- Directing assets to designated persons
- Tax planning and tax savings
- Naming executor(s) and trustee(s)
- Appointing guardian(s) if needed
- Establishing trusts to take effect at death, including:
    - Trusts that delay receipt of an inheritance by minor children
    - Trusts that multiply access to the graduated rate of tax for tax savings
    - Special needs trusts that make funds available for disabled adults
- Creating multiple wills for probate planning in certain provinces
- Creating spousal trusts to provide for a spouse during his or her lifetime, and to preserve wealth for heirs

Double Taxation on Private Company Shares

Double taxation may arise where the individual owns a private company which holds assets which have appreciated in value. When the individual dies there is a deemed disposition of the private company shares for fair market value. This fair market value includes the appreciation in value of the assets held by the company. However, the company does not receive a step-up in the cost of the assets it owns to reflect the gain realized by the individual upon their death. Consequently, when the assets are sold by the private company, the appreciation in value of the assets will be taxed at the corporate level.

Proper tax planning may minimize or eliminate the amount of double taxation that would otherwise occur when the individual holds private company shares at their death.

Life insurance coverage

Life insurance is a contract between an insurance company and the insured. In the contract, the insurance company agrees to pay a stated amount of money to a beneficiary upon the death of the insured in exchange for a sum of money, known as the premium, paid by the policyholder. The primary functions of life insurance are to pay off debts outstanding at the time of death, to pay any income taxes resulting from the insured's death, to cover expenses created by the death itself, and to provide financial security for the family of the deceased.

A reasonable approach to determination of your life insurance needs is to examine the following specific areas:

- Capital resources (the funds available upon your death)
- Taxes payable (the amount of income taxes that will be payable as a result of your death)
- Capital needs (the cash needs at your death)
- Survivor income needs (the cash your survivors will need during their lifetimes)

Depending on the circumstances, proper planning could include life insurance being held by a corporation as well as by you personally. For example, where you are still a shareholder of a company, it may be advisable for the company to have a life insurance policy on your life in order to finance the buy-out of your shares upon your death. The terms of such a buy-out could be included in a shareholders' agreement between you, the other shareholders and the company.

Powers of attorney and living will

In the preparation of a will and its contents, individuals should consider powers of attorney and a living will.

Powers of attorney - A power of attorney is a legal document allowing one person (the principal) to authorize another person (the agent) to act on the principal's behalf. The power of attorney may be specific to a particular asset, or it may cover all of the principal's property.

General Power of Attorney

A general power of attorney under a provincial Power of Attorney Act may be used where it is not intended to survive the principal's incapacity. Generally, this power of attorney is limited to an activity, a particular authority, or a time period.

Continuing Power of Attorney

A continuing power of attorney is intended to survive the principal's incapacity and provides the agent with authority to deal with property during the principal's mental incapacity or during a medical emergency.

Living will – This is a written statement of a person's wishes and instructions regarding the kind of medical treatment they want if terminally ill. It is commonly used for instructing that no extraordinary measures be used to extend the person's life or that the person wants all available medical treatment.

Trusts

Trusts have long been considered the cornerstones of effective estate plans. A trust is a legal arrangement whereby an individual (the settlor) transfers property, along with instructions to a trustee to manage and distribute to the trust beneficiaries as outlined in the trust document. Whether established during one's lifetime or upon death, a trust provides significant tax and non-tax benefits for the trust settlor and for beneficiaries. When carefully designed and managed, trusts can provide for and protect your family members while allowing you to set initial parameters regarding the management of those assets. Trusts can be used for a variety of purposes, including assisting in the management and distribution of assets and in minimizing taxes. Some of the more common trusts used in wealth management and transfer include:

Spousal Trust – A spousal trust may be created during your lifetime or as part of your will. A spousal trust created during your lifetime allows you to transfer assets to a trust for your spouse on a tax-free rollover basis. However, income earned on the assets transferred to the spousal trust may be attributed back to the donor during the donor's lifetime.

A spousal trust that is created as part of your will allows you to pass on your assets to your surviving spouse for use during his or her lifetime without you paying any income taxes on those assets as a result of your death. Upon your surviving spouse's death, any assets remaining in the spousal trust may be distributed in accordance with the terms of the trust.

Alter Ego Trust – An alter ego trust is a trust which holds your assets for your sole benefit during your lifetime. Upon your death, the property in the trust is distributed according to the trust terms as set up by you. Advantages of an alter ego trust include: avoidance of probate fees on the assets held by the trust, and privacy as the terms of an alter ego trust do not become a public document like a will.

Joint Spousal or Common Law Partner Trust – A joint spousal or common law partner trust provides advantages similar to an alter ego trust but with both spouses being beneficiaries of the trust. The assets of a joint spousal or common law partner trust will be distributed upon the last to die of the spouse or common law beneficiaries.

Testamentary Trusts – Setting up trusts for beneficiaries under your will (known as testamentary trusts) allows income on property held by the trust to be taxed at the graduated tax rates thereby reducing the amount of tax payable on the income.

Private Foundations and Donor Advised Funds

A private foundation is a charity that is typically created by families to effectively direct charitable donations. The charitable purposes of a private foundation may focus on the funding of charitable organizations that the family wants to support, or the private foundation can be constituted to carry on charitable activities directly.

Private foundations offer the following benefits:

- The charitable and philanthropic objectives of the donor may be carried out in perpetuity
- The donor may claim a charitable tax relief for the year that the contribution is made and make actual distributions to charity in later years
- The donor and family members can control the administration and investment of assets of the foundation, as well as grant decisions
- The donor may address specific charitable objectives that may not be addressed by other organizations

A donor advised fund is charitable contribution that is made to a charity (typically a public foundation). The family donor then advises and provides non-binding input to the foundation as to how the funds should be directed. A donor advised fund allows a donor to provide input as to the grants and decisions, but avoids the administrative burden and cost associated with establishing and operating a private foundation. Many of the large Canadian chartered banks offer donor advised funds.

Registered Education Savings Plan (RESP)

An RESP is a tax efficient way to save money for education (typically for a child or grandchild). Contributions to an RESP may be invested tax free until such time that the funds are withdrawn to pay for a beneficiary's education expenses at which time the income is taxed in the beneficiary's hands(usually at a lower tax rate).

Systematic approaches to wealth management and transfer

An effective plan will meet your objectives.

Former private company owners need tax-efficient means for preserving wealth and transferring it to successive generations. An appropriate plan—blending personal, financial, and tax considerations into a comprehensive family wealth transfer strategy or business succession plan—preserves a family's wealth for the individual and their heirs. An effective plan will meet your objectives, whether those objectives are to maximize the benefits of ownership and assets; distribute assets to family members or charities; appoint capable estate managers as executors and trustees; minimize taxes, probate, and administrative costs; and/ or ensure the liquidity and stability of your estate.

However, the complex nature of the income tax rules have made this increasingly difficult. In addition, a busy life makes it difficult to dedicate sufficient time to the planning and administration of personal financial and business affairs. A total wealth management approach to financial planning, using appropriate advisors, ensures all the wealth management plan elements are coordinated, and that you'll receive comprehensive advice, allowing you to focus on personal aspirations, rather than financial security. An advisor-managed systematic approach can help coordinate planning among:

- Tax compliance
- Tax consulting
- Investment advising
- Wealth transfer strategies (Will and trust planning)
- Human resources services
- Family business succession planning
- Insurance-risk management
- Administrative services
- Charitable planning and administration
- Education funding
- Retirement planning
- Beneficiary designation planning

The family office

For a number of high-net-worth families, wealth management has become multigenerational, creating a strong demand for tax, estate, and philanthropic services, among others. A key trend has been for these families to create so-called hundred-year plans, where family members are treated as business divisions and emphasis is placed on corporate-inspired guidelines such as family mission statements, governance structures, and guidelines for communication.

In addition, dealing with the day-to-day affairs of family wealth management is time intensive. Coordinating various advisors, monitoring investments, and conducting daily financial activities can all be daunting tasks. Further, family stakeholders may not be able to objectively evaluate the services performed or be aware of what is available to them. Establishing a family office to manage a family's business, family entities, investments, and/or personal activities may help ease the burden of managing wealth effectively.

A family office offers a unique way for a family to manage wealth, maintain family continuity, and advance the family agenda. In the context of a family office, professional advisors can help identify and evaluate current and future wealth management objectives, increase tax efficiencies, reduce administrative costs and further advance the family agenda.

Welcome to the rest of your life

You've successfully navigated the exit from your business. As you turn toward the future, what is best for you based on your own individual needs and desires?

Your vision for your family's future—and its financial security—is uniquely your own. We trust that the thoughts in this publication will help you begin to navigate that future.

About PwC's Private Company Services

More than 65% of PwC Canada's clients are private companies, ranging from high net worth individuals to owner-managed family businesses and large, professionally-managed businesses. PwC's Private Company Services (PCS) group is a dedicated team of business advisors who help private company owners resolve day-to-day business issues and achieve long-term success. PCS offers the perspective of a third party with professional industry knowledge, business consulting, tax and accounting expertise.

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