The TaxLetter®
Vol. 37, No. 6 Your Guide to Tax-Saving Strategies June 2019

## ESTATEPLANNING

### *Family-Owned Business*

# Challenge & Opportunity

**Mark Halpern, CFP, TEP**

*"By failing to prepare, you are preparing to fail."*
*Benjamin Franklin*

A happy client introduced us to the owners of a successful company started by a young couple in the 1960s. The no-longer-young couple we'll call Joel and Sandi Smith started the business with a modest $1,000 investment. It is now a thriving family business worth $50 million.

They had a major concern knowing their estate would face a huge tax liability upon the death of the second spouse. At that point the federal tax department would be on course to collect more than one quarter of the difference between $1,000 and $50 million, roughly $12.5 million.

Most family-owned business owners, including the Smiths, classify the ability to pass on their company to the next generation as their No. 1 objective. In many cases though, a tax liability prevents that from happening. However, we reassured them that with proper planning their desired outcome could be achieved.

We showed them how they could deal with that tax liability through various means, including life insurance. The Smiths are philanthropic and wanted to know how this could affect the final tax bill. On top of that, they had questions about how they could equalize financial treatment for their children, not all of whom wanted to be part of the company.

### Strategies for a tax liability

The first thing we did was meet with each of the adult Smith children individually, asking them about where they saw themselves going in the next few years. This would give us a good foundation to determine where the company was going after Joel and Sandi were no longer around.

After those discussions, we determined there was indeed great interest from two of their kids to move forward with the successful company. Both parents were delighted to hear this result. They had asked their children the very same questions in the past, with different results. But often, when an outside person is involved, people open up with more straightforward answers.

As part of our work, we collaborate with many different professional colleagues – accountants, lawyers, actuaries, bankers – to develop strategies that achieve the best possible outcome for our clients long before any products are introduced.

### Joel and Sandi

Following discussions with these professionals, we showed Joel and Sandi several available strategies to lower the final tax bill, including using life insurance. With the understanding that life insurance proceeds flow tax-free to beneficiaries and bypass probate, they agreed

Mark Halpern is a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and one of Canada's top life insurance advisors. He is CEO of WEALTHinsurance.com® and illnessPROTECTION.com®, with special expertise for business owners, entrepreneurs, medical professionals and high-net worth individuals and their families. He can be reached at 416-364-2929, toll-free at 866-566-2001 or mark@WEALTHinsurance.com.

it was the most cost-effective and tax-friendly solution available to deal with future tax liabilities, exactly what they were looking for.

While two of the adult children were happily anticipating their futures with the company, the other three had no interest in staying with the company.

Joel wanted to ensure that his children would receive "equal" compensation when he and his wife pass away. Accordingly, he wanted to name all of them as equal beneficiaries of the business.

We explained to him that this could create a problem. How can the two staying in the business effectively run the company when they could be vetoed by those "on the outside?" How will the siblings not in the company feel about relying on the others to make sure the business keeps going?

We sat down with the parents and suggested to them they implement an "equitable" plan that leaves the entire business to those working in the company, while life insurance proceeds would go to the other children as their fair share of the business.

We suggested that those remaining in the company should own a proper share in the business and cement it with a shareholder agreement. Doing so will preserve the future ownership of the company and articulate the parents' succession plan.

Buy-sell provisions in a shareholder agreement make it clear how shares will be transferred when a partner retires, becomes disabled, dies, goes bankrupt or has a marriage breakdown. They can also stipulate that if one of the shareholders wants to sell his/her shares that key people or other staff be kept on in the company.

## Charities

With this nagging worry behind them, the Smiths moved on to their next goal: to leave funds to their favourite charities.

In our experience, most wealthy Canadians have a great love of philanthropy. While their life goals include leaving hard-earned savings to their children and minimizing taxes, they sincerely care about creating a charitable legacy to inspire their children and grandchildren.

Here again insurance shines. We explained that an insurance policy can be purchased with the charity named as beneficiary. In this case, the premiums qualify as a tax deduction on Joel and Sandi's annual income tax returns. They can also buy a policy and name their estate as the beneficiary and include the charity as part of their will. In this case, they can't get a charitable donation credit for the premiums, but the charity will issue a tax receipt for the inevitable final tax return.

If they don't want to include a life insurance policy, they can create an endowment, which entails providing an irrevocable gift to either a private foundation or what's known as a donor-advised fund (DAF) within a public foundation.

With the succession and philanthropy issues addressed, Joel wanted to implement a system for an annual review to make sure the company stays with the times and enables consistent updates in the future.

Joel realized that while his family has worked hard and done well, their work wasn't done. He understands that it's important to protect the family's wealth and make the right decisions to ensure that their family capital remains strong enough to benefit future generations.

Over the years, we've met hundreds of successful people who did take the time to make a financial plan, but it was done many years ago, often just as their business was taking off. But their goals were never been reviewed and/or upgraded. I compare this to having old financial furniture that doesn't fit their current architecture.

Reviewing clients' old protection portfolios, we have discovered former smokers who are still paying the much higher smoker premiums for insurance; people in their 60s paying long-term disability premiums for policies that expire when they turn 65. Surely that money could have gone to better use.

We realize that people are busy looking after their clients and their employees and don't have time to look after themselves. That's why putting regular updates in place is key to the future of a company.

With those issues in mind, we held a meeting with executors, senior management and advisors. Both Joel and Sandi were keen on ensuring that if they were no longer able to help, their company would be able to successfully proceed based on this plan of action.

As the Smith company was set to grow further and his adult children moved into leadership roles, Joel believed the next step was to structure a family office.

There are many variants of the family office, all of which provide advice and services for ultra-wealthy families under a comprehensive wealth management plan. Most family offices combine asset management, cash management, risk management, financial planning, lifestyle management and other services to provide each family with the essential elements for addressing the pivotal issues it faces.

Most well-organized families adopt a family constitution and council that can assist in resolving disputes and reducing tensions, ensuring that the family office can concentrate on its administrative responsibilities.

In the end, Joel and Sandi found a cost-effective way to deal with their after-death financial issues via life insurance. They now have some great ideas to ensure their philanthropic goals are achieved. And with two of their adult children at the helm of the Smith business, Joel and Sandi are confident that their values are safeguarded for future generations.

If you are a business owner, please contact us for a no-obligation consultation. Our advisors across Canada are available to help you. ❑

---

Mark Halpern is one of Canada's top life insurance advisors, a Certified Financial Planner (CFP), Trust and Estate Practitioner (TEP) and CEO of WEALTHinsurance.com®.
He guides successful business owners, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of.
If you are like his other successful business owner clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy. Incompletions rob us of energy. Mark collaborates with your professional advisory team to achieve your desired outcomes. His approach is simple. He makes sure what is important to you gets done. He gets you organized, provides a big picture view of your financial affairs, determines your strategy and helps you take action. He will simplify the complicated, so you and your family can rest easy. He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or Mark@WEALTHinsurance.com.
Visit WEALTHinsurance.com
Get your FREE Estate Planning Toolkit at WEALTHinsurance.com/toolkits.html
The 2019 Toolkit now includes:
Estate Directory
Estate Planning Checklist
Executor Duties Checklist
Business Owners Planning Guide
Visit MarkHalpernBlog.com and sign up for free updates.