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ESTATEPLANNING

Private Company Share Donation Strategy

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I have a lot of respect for fellow business owners who worked hard to build their firms into successful enterprises. Despite all the adversity along the way, they managed to survive recessions, business downturns, sky-high interest rates, stock market meltdowns, stifling taxation, and more recently a global pandemic.

Creating and growing a business keeps you and roughly 1.1 million Canadian business owners going. Your determination continues to pay off, providing your family with a home, financing your lifestyle and perhaps a recreational property and well-deserved vacations.

Business owners do enjoy some unique money-saving opportunities that are not available to other taxpayers.

And if you are a business owner, post-mortem planning is essential now to avoid double (or possible triple) taxation of up to 70 per cent when you die. This article explains some cost-effective strategies to preserve your wealth, pass it on to family tax-effectively and create a meaningful charitable legacy too.

Preserving Your Wealth

Being successful allows you to transition from success to significance. You do not have to be rich like Bill Gates or Warren Buffett to be philanthropic. With proper planning you can become a philanthropist and create a charitable legacy that will inspire your children and grandchildren, as well as other like-minded individuals to follow your example.

As a business owner, you now enjoy an indexed $883,384 lifetime capital gains exemption. Since only half of any capital gain is taxable in Canada, the actual dollar value of the exemption will be a little over $441,000. Obtaining the maximum benefit of the exemption is something you need to start planning for 3 to 5 years before you exit the business.

Proper planning now can prepare your estate to pay your 'final tax bill 'after you die. Without planning, your family may face a financial mess, and be forced to sell some of your assets, including the business, to come up with funds to pay the tax bill.

Great Value in life Insurance Products

One of the most cost-effective ways to fund liabilities like your tax bill is to use life insurance products. For literally pennies on the dollar, you can mitigate your final tax bill and still provide an inheritance to your family. In addition, you can use 'corporate' dollars vs. personal, after-tax dollars, to acquire your life insurance. My May 2018 TaxLetter® "Corporate-Owned Life Insurance" explains why business owners buy corporate-owned life insurance, and how they use leverage arrangements

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to acquire it, allowing them to keep their own money working in their business or investment portfolio.

If you own private-company shares, several benefits unavailable to other taxpayers are open to you. Your overall estate plan may not include having a charity own part of your business, though once you understand the 'why and how', you may embrace the strategy.

Using an Estate Freeze, you can tax-efficiently pass along the future growth in the value of your company to your children. Its purpose is to fix or freeze an asset's fair market value for tax purposes. This allows you to determine with some certainty the amount of the tax liability you would face. After the freeze is put in place, any future growth in the asset's fair market value accumulates for the benefit of others, usually a business owner's children or a family trust.

Private company shares held by an individual at the time of death are subject to capital gains. But if those shares are donated to a registered charity, the tax burden on the estate can be reduced substantially.

Private company shares can be hard to value and the organization you donate to would need to find a buyer to convert the shares to cash. Repurchasing the shares from the charity is accomplished by using the proceeds of life insurance paid for by the corporation.

Here's an example: Joe is a major shareholder who owns fixed-value preferred shares of a private corporation that have a redemption value of $50 million and nominal adjusted cost base. When he dies, his will directs the estate trustee to donate half of the preferred shares to charity. The corporation is the owner and the beneficiary of the life insurance policy on the shareholder.

The corporation receives the life insurance proceeds tax-free.

The entire death benefit from the life insurance policy (minus its adjusted cost basis) creates a credit in the capital dividend account (CDA) that the company may use to pay tax-free dividends to Canadian resident shareholders. The corporation uses the insurance proceeds to redeem the preferred shares gifted to the charity. Now the corporation retains the CDA for any surviving shareholders.

What started out as a capital-gains tax liability of roughly $13.4 million ends up being a donation tax credit of $12.6 million and net estate tax of roughly $800,000, as well as a tax-free capital dividend for the surviving shareholders.

Income Reduction as Tax Advantage

You can make better use of your donation tax credits and reduce income tax payable by your estate by instructing your executors to designate your estate as a graduated rate estate (GRE). This allows them to claim donations of as much as 100 per cent of net income in your final tax return with a one-year carry back.

While an estate freeze is productive, it can be difficult to value the shares and may require the knowledge of an independent business valuator.

The Immediate Financing Arrangement (IFA) is another helpful tool to facilitate your donation of private shares.

Use the IFA to acquire permanent life insurance. Your insurance policy Cash Surrender Value (CSV) can serve as collateral to secure a line of credit with a Canadian chartered bank. Use those borrowed funds for other investments, making the interest cost tax deductible because you are borrowing to invest. With current interest rates of less than 4 per cent the real net interest cost is about 2 per cent. For example, a large life insurance policy with an annual premium of $100,000 can be structured using the IFA, with net-after-tax interest cost of $2,000 for the first year that increases as additional premiums are paid and borrowed back.

On death, the proceeds of the life insurance policy are used to pay off the loan balance, with the remainder going to family and/or charity.

Do it now while the sun shines

Planning while the sun is shining is incredibly important, otherwise you could miss out on a great opportunity. Like the woman in her 50s who recently sought our advice on behalf of her siblings and elderly parents. Her parents, 90 and 85, personally own a portfolio of commercial real estate worth $50 million but are too old and unhealthy to qualify for life insurance. The family could have used inexpensive life insurance, at a cost of pennies per dollar, to pay the roughly $13.4 million tax liability that will be due when the parents die.

It is now too late to do the

comprehensive tax planning that should have been completed years ago, when the parents were younger and insurable. They will be forced to sell valuable income-producing assets just to pay the tax bill when the parents die.

The current pandemic should have convinced most people of the need to plan. Tax increases are expected because governments at every level are spending billions to help Canadians deal with health issues and financial challenges. Who will pay for that?

Governments will want to collect higher taxes from all successful Canadians. Income tax rates may rise further – already 54 per cent in Ontario - and capital gains taxes may increase from the current 50 per cent to 75 per cent. A new wealth tax is anticipated.

Philanthropy is a wonderful way to reduce or eliminate your tax exposure. Donating some of your private company shares to a favourite charity can save you millions in taxes for thousands of dollars.

Get professional advice from estate planning and insurance professionals to preserve your wealth.

Contact us for a no-obligation consultation or to get a second opinion on your current planning. ❑

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He guides successful business owners, who are already challenged for time, through the com plex 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.
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