

BUSINESS: THE NEXT GENERATION (PART 2)

by Craig Zawada

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In “Business: The Next Generation”, we talked about succession planning for businesses and finding a buyer. In this article, we’ll discuss steps which can be taken to make the transfer easier, whether it is imminent or far in the future.

I’ll repeat one thought from the last article: the earlier these steps are taken, the better. It is obviously impossible to accurately predict what will be needed if one is only planning on “getting out in 10 or 15 years”. This doesn’t mean that nothing can be done, though. By ensuring that things are under control now, opportunities can be taken advantage of more quickly, and with less cost.

Sometimes the simplest procedures are the most important. For example, keep business records up to date and comprehensive. This includes financial statements, minute books, and other business documents. This is also valuable for day to day operations, but if opportunity knocks, having the information quickly can be the difference between completing a sale or not.

The details that seem minor now may also become more prominent later. For instance, the business might be habitually late with certain payments or filing fees. This may not cause a serious problem operationally, but an outside purchaser might consider these to be more important, and will look at the deal more skeptically.

One of the things that is commonly neglected in a corporation, often with perilous results, is a unanimous shareholders agreement. One feature of a USA is that it can control and bind the directors of a corporation, notwithstanding how the votes on shares are allocated. For succession planning, however, the key feature of a USA is the “buy/sell” provisions.

Buy/sell rules can be triggered in many different cases, but they often apply on the death of a shareholder, when one shareholder wishes to sell their shares, or if there is disability or marital breakdown. In such a case, the USA acts as a road map for disposition of the shares – how it is done, how much is paid, when it is paid, and so on.

In my experience, the benefit of a USA is not so much how disputes get resolved (although this is important) but that it prevents most disputes in the first place. The very act of negotiating a USA forces parties to turn their minds to things that they wouldn’t, or would rather not, think about when the business is fresh and exciting. Each party gets a better picture of what is important to everyone, and can adjust their expectations accordingly.

Tax liability is always a concern when selling a business. In most cases, there will be *some* tax, but it can be minimized. What are some ways of doing this?

For the moment, there is still a \$500,000 capital gains exemption when selling shares of a qualifying small business corporation. Not all shares are “qualifying”. For example, there is a requirement that the company have minimum levels of active business income. Steps can be taken to “purify” corporations, but it cannot usually be done immediately. Therefore, business owners should look to the future and determine what can be done now to ensure the maximum deductions are available later.

In conjunction with the capital gains exemption, or perhaps in substitution, an “estate freeze” can minimize tax. A freeze does just what it implies. It usually involves exchanging the

shareholder's current common shares, which increase in value as the company grows, with preferred shares. The new preferred shares are non-participating – no matter how much the value of the company changes, the preferred shares retain the same value. As part of a freeze, new common shares will be issued to someone else, usually a child, so that future corporate growth (and capital gains tax) accrues to them.

An estate freeze works well when the original owner believes that he or she has enough assets, and doesn't want the tax hassles of further growth. It can also be set up so that voting control continues to rest with the original owner.

These are only a few of the techniques used in contemplation of succession planning. In a well thought out plan, not only will flexibility be increased for the future, there may even be some immediate benefits. And remember – succession planning is a process, not an end result. It is important to regularly monitor the business situation, in conjunction with advisors, and determine if any new directions are necessary.

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