

# Enterprise Tax on Demand

Planning for tomorrow, today: Key factors to consider in the growth phase of your business

## Episode 3: Planning for tomorrow, today: Key factors to consider in the growth phase of your business

The growth phase of a business is an exciting step, but key decisions made now can have a significant impact on the future. In this episode, Andrea Milo, Partner, Enterprise Tax and Family Office discusses key factors to consider in the growth phase of a business, including building an efficient tax strategy and planning for a future sale or transfer to the next generation.

*Speaker: Andrea Milo, Partner, Enterprise Tax and Family Office*



With more than 20 years of experience, Andrea is a tax Partner at KPMG in Canada's Enterprise and Family Office practices. She is known for her insights and focus on private companies, entrepreneurs, and family businesses.

Andrea helps clients navigate both business and personal tax challenges from day-to-day business operations to strategy development in order to enhance personal and family wealth. Andrea's tax experience spans across both domestic and global organizations (public and private), Canadian corporate tax compliance, Canadian and U.S. domestic and cross-border personal tax compliance, tax authority audits and disputes, tax due diligence, tax-effective structuring of acquisitions and divestitures, compensation strategies and estate and succession planning.

### Episode highlights

Time	Topic
00:00 – 01:23	Introduction
01:23 – 05:15	Revisiting your holding structure
05:15 – 09:35	Exploring estate and succession planning opportunities
09:35 – 10:12	Summary and conclusion

For more on the Enterprise Tax on Demand series visit [home.kpmg/ca/enterprisetaxondemand](https://home.kpmg/ca/enterprisetaxondemand).

## Andrea Milo

Hello everyone, I'm Andrea Milo, a tax partner at KPMG Canada and I'm pleased to welcome you to the third episode of five in our Enterprise Tax on Demand series. Our series digs into all aspects around the life cycle of a business.

If you were with us for episodes one and two, we explored what one family business, a window and door manufacturer, needed to do to get its company off the ground.

Today's episode will focus on the growth stage. As we all know, it's the dream of many Canadian family business owners to transfer their businesses to their adult children or grandchildren when they retire. A key part of "growth" involves putting the right business structure in place and making strategic decisions for the future and that's what I'm going to dig into today.

Our family manufacturing company needs to make several important decisions in the growth stage. First, it needs revisit its holding structure to make sure it's still effective and second, it should explore estate planning opportunities.

Selling or transferring the business might be the last thing on our family's mind during the growth stage, but we recommend that they at least keep it in mind and that requires some preparation, and I'll cover what I mean by that later on.

When revisiting its holding structure, our family should ask itself two questions. One: Does this structure work with our growth strategy? Two: Does this structure make sense from an exit or succession point of view? So, a few examples will help illustrate this:

1. First, let's say our family wants to acquire a new building. It might change its holding structure and create a separate entity to acquire and hold the new real estate. This way, the real estate won't be available to creditors of the manufacturing business and if the family ever sells the business to a third party, the real estate will not have to be sold along with it.
2. Second, if the family's operating company has excess cash during the growth stage, it may be a good time to set up a holding company or a family trust. This is a good way to credit-proof the business and could help maintain the company's status as a small business corporation. That status is really important down the road if the business is sold or transferred to the next generation as it potentially enables family members to use their lifetime capital gains exemptions which, in 2022, can offer tax savings of roughly \$245,000 on the sale of qualified small business corporation shares.
3. Third, if the family wants to grow via acquisitions as opposed to organic growth, it needs to realize that a share or asset acquisitions have different tax implications. Some structures could be more desirable than others based on what the family's ultimate exit strategy is.

4. Fourth, let's say the family wants to go global with its products and its brand. They can expand their business outside of Canada either organically or via acquisitions, but in either case, the family would need a foreign holding structure and operating model that builds in worldwide tax efficiencies and allows for effective cross-border repatriation of profits.
5. Fifth, if the parents who founded the business don't have life insurance, they might want to get corporate life insurance and finance the premiums with company dollars instead of using after-tax personal dollars. Proceeds from both personal and corporate life insurance are tax-free, so if one of the parent-owners passes away, those proceeds can be used in all kinds of different ways. For instance, they might cover any future estate tax burden the remaining family members might be left with.

Corporate life insurance might also serve as loan protection or provide collateral for financing. It can also help shore up working capital, be used to repay debts, or be put towards hiring and training a new person to run the company.

Now, not every family wants to be involved in the business after a primary owner passes away. And in this case, corporate life insurance proceeds can also be used to buy out the shares owned by the deceased shareholder's estate or by the beneficiaries. This could really help to keep the business running while providing cash to the deceased's beneficiaries.

6. Finally, if the company doesn't have a shareholder agreement, it really needs one. Families sometimes, we find, skip this process, thinking of themselves as spouses or parents first, rather than as shareholders. But having a shareholders' agreement is critical. It typically contains a range of important provisions. Things like what to do in case of disability or death of a shareholder, the requirement for a domestic contract before marriage or cohabitation of a shareholder, buy-sell or mandatory purchase provisions, provisions for the first right of refusal, the requirement for shareholder life insurance, etc.

Now, earlier I mentioned the importance of always being ready for a potential sale or transfer to the next generation.

Let's say in our situation, the parents want to retire and are planning to transfer the windows and doors business to their child. They need to start thinking about this far in advance. There are strict asset and holding period tests that they must adhere to for two years before any sale or transfer in order to qualify for the lifetime capital gains exemption.

They may also want to put a family trust structure in place, which can help the business maintain its small business corporation status. As I mentioned earlier, this is important down the road if there's ever a sale or transfer to the next generation. A family trust structure can also provide the family with certain income splitting opportunities, such as multiplying the lifetime capital gains exemption with other family members.

A key part of the growth stage is estate planning and succession planning. Let's say our door and windows manufacturing company is owned solely by one parent of the family. Our family will want to have a plan in place in case that parent passes away.

When someone dies, all of their capital property owned immediately before death is deemed to have been disposed of. With certain exceptions, this disposition occurs at fair market value.

If the individual is married at the time of death, as in our case, their assets can generally be transferred to their spouse on a tax deferred basis if provided for in their Will. In that case, only when the second spouse dies will any capital gain on the deemed disposition of property held be taxed.

If the fair market value of the assets exceeds the tax cost, the resulting taxable capital gain will be included in the second spouse's income for that taxation year, with the resulting income tax to be paid by the estate.

If the deceased is a business owner and the owner's shares increased significantly in value, there could be a hefty tax implication. But, since shares of private corporations are generally not marketable and so not easily convertible into cash, there may not be sufficient cash in the deceased's estate to cover that income tax liability.

But family business owners can plan ahead for this situation by implementing what is called an "estate freeze". What this does is cap the tax liability on death based on the value of the company at the time the estate freeze is implemented and shifts the future growth in value of the business to the beneficiaries. With that liability capped, the business owner can plan for the funding of that liability through life insurance or other assets. The owner might also redeem those frozen shares during their lifetime and use the redemption proceeds to fund their retirement. Those share redemptions would reduce the ultimate tax liability on death since tax would be payable over time as the shares are redeemed.

There are many estate and succession strategies available to family business owners, but it is critical to plan ahead. Family businesses are unique because there are family dynamics to consider. With succession planning, it's important to keep family members in the loop and communicate clearly and openly.

Think about your family values, your vision, your mission, and get alignment with family members on the purpose of the family's wealth. Whether or not the next generation will be involved in the business, they will be involved at some point with the estate and other matters.

Let them know your wishes and make sure they have the financial literacy to cope with the transition of the business and the family wealth.

Growing a business is rewarding and exhilarating, but the structure really does matter. So, make sure you're structuring things in a way that will serve you down the road. That means building in tax efficiencies and planning for a future sale or transfer to the next generation.

Thanks for joining us today for the third episode of Enterprise Tax on Demand. In our next episode, we'll dig a little deeper into tax planning details for a divestiture or intergenerational transfer.

This video series shares thought leader perspectives on key Enterprise Tax topics throughout the lifecycle of a private Canadian company.

Stay tuned for new episodes and visit our site at [kpmg.ca/enterprisetaxondemand](http://kpmg.ca/enterprisetaxondemand) for more information.

*Musical outro*