SUCCESSION PLANNING KIT for CANADIAN BUSINESS

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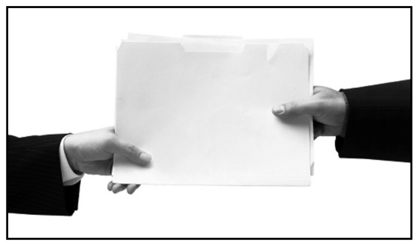

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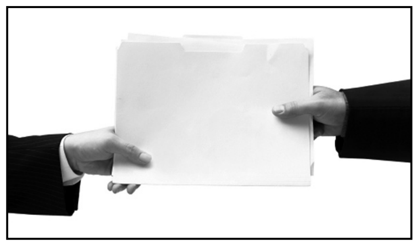

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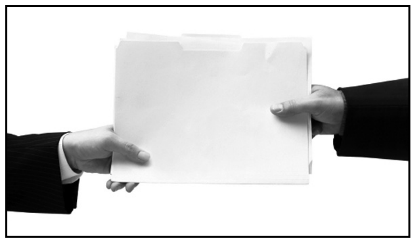
Introduction



Small and midsize family-owned businesses operate in Canada in almost every industry and market. They range from one or two employees to hundreds of workers. According to a survey done by the Canadian Federation of Independent Business (CFIB) in 2007, 97 percent of all Canadian businesses have less than 500 employees.[1] Statistics Canada says that 75 percent of all businesses in Canada employ fewer than five employees.[2] There can be no doubt that private-business owners like you are an extremely important part of Canada's economy.

These businesses were founded by hard-working individuals who found ways to make their businesses flourish. Often, business owners operate their businesses for many years, possibly even their entire working lives, devoting creativity, energy, time, effort, and financial resources to them. Many are deservedly proud of the achievement of growing a successful business. Despite the success of these businesses, the majority of entrepreneurs have not planned for a way to retire, sell their business, or pass on the business to another person (often referred to as an *exit strategy*).

Every business that is now owned by a single owner will one day either be wound up or passed to another person as the current owner retires, sells the business, or passes away. For many business owners, the day they leave their business seems quite far in the future so they do not feel any urgency to make plans for it. They are more concerned with growing the business and keeping it going. As you will see from reading this book, it is never too early to begin the planning that will ensure that one day you will be able to leave or sell your business to someone else as a going concern.

The fact that you are reading this book probably means that you are beginning to think about your own exit strategy. You are likely

[1] Aneliese Debus, "Small Business, Big Value: How Canadians and Entrepreneurs See the Value of Business Ownership," *Canadian Federation of Independent Business*, www.cfib.ca.

[2] Statistics Canada, Employment Dynamics (2002)

wondering how important it is that you have an exit plan set up. Do you ever wonder what other business owners like yourself are doing to prepare for their retirement or sale of business? Do you wonder how long it really takes to put a succession plan into place, and what the most common problems are? The firm of BDO Dunwoody LLP, chartered accountants, released a study that showed that 92 percent of owners of small- or medium-sized businesses felt that it was important to have an exit strategy for them to one day leave their business. However, only 44 percent of business owners actually had such an exit strategy in place, and almost half of that 44 percent said they were only at the stage of "thinking about" their exit strategy and had not yet actually done anything about it.[3] This means that if only 22 percent have actually put something in place, a full 78 percent have not done anything beyond thinking about it.

These numbers plainly show that most business owners are aware of the need to make plans, but have not yet done so. This situation is probably familiar to many business owners reading this book. The figures are not really surprising, given that so many business owners devote a large portion of their time and energy to the day-to-day running of their operations. The level of commitment and energy needed to run a successful business does not always leave a lot of spare time for planning to exit it.

If you are among the 78 percent of business owners who have not yet done anything about business succession planning, this book will give you plenty of information about your options and give you some ideas about planning for the day when you eventually leave your business behind. It will help you turn "thinking about it" into action. You may already have a good idea of what you want to do, or you may be completely open to suggestions. Either way, you will find this book packed with practical ideas about how to go forward.

Several accounting firms and business organizations have done studies and surveys of Canadian business owners in recent years. The results of some of those studies are mentioned in various chapters of this book. The studies help to show you as a business owner how you fit into the business world. They give examples of what other business owners are doing or have already done to deal with their own succession planning issues. Often seeing what other people are doing gives you ideas about what might work for you. You will also see from these studies that there is rarely any one right way to do anything, as all businesses and their owners are unique. You might borrow ideas here and there from other people's successful plans, but in the end, your business succession plan will be unique to your business.

This book looks at possible options for who might take over your business one day (known as your *successor*), including family members, employees and management, and independent (i.e., non-family, non-employee) purchasers. Succession planning does not only apply to passing the business on to your children. This book will talk about succession to family members but will also explore many other options. Each situation will be examined separately as there are vastly different arrangements available depending on who will be taking over.

Taxation is always a major issue for business owners who want to dispose of their businesses. Because tax is so prominent an issue, this book will look at taxation issues that arise with various possible ways of transferring a business. If you, as a business owner, do not anticipate that taxes will be levied against the transfer of the business — and find a way to have money

[3] Conrad Winn and Bruce Ball, *The BDO Dunwoody/Compass Report on Canadian Family Business*

available to pay it — you might end up selling part of the business or its assets just to pay the taxes. If the tax liability is very high, you might even have to sell some assets that are essential to the business, such as land, buildings, or equipment.

In some cases, the loss of these assets means that the business simply cannot carry on any longer and your plans for passing on the business to someone else will not be possible. Your business might have to fold. Or, you might end up losing the money that you had planned to live on during your retirement. It is essential that you know ahead of time how your succession plan will be affected by taxation. This book not only talks about the taxes that might arise, it gives some suggestions for minimizing them and finding ways to have money available to pay them.

Selling is often an attractive option. Should you sell your business, and if so, how would the sale be structured? Should you pass your business on to a family member, and if so, how is that done? What if you cannot find a successor? What if you think you have a suitable successor but he or she is not ready yet to run your business? What are some of the hidden issues, such as family dynamics or treating all of your children fairly in your will, that business owners do not always hear about when consulting their business advisors? Chapter 2 introduces and summarizes the options available.

Reading this book should give you a firm idea of what kind of succession arrangement might work for your particular situation. It should help you think about the alternatives that are available specifically to you based on the kind of business you own, what the economic outlook is for your industry, whom you are considering as your successor, and how soon you want to make the transition.

As you go through this book, you should think about and solidify your own goals and priorities. For example, you should be thinking about when you want to transfer your business. Timing is an issue that must be considered at the very beginning of your planning process. Are you thinking of retiring, and if so, when? If you are not thinking about retirement but want to sell your business or transfer it to your children, when will you be ready for that to happen? Do you visualize needing a succession plan in six months, a year, or ten years? Are you planning to fully retire from the business or only to semiretire for now? It is very important that you set a solid time line that you and everyone else involved can work with. Chapter 3 goes into detail about setting up a realistic time line.

Family issues may make succession planning more difficult due to the interpersonal dynamics of the group. This is the case with almost all families, even those who get along well. These issues are sometimes true roadblocks but they can be managed with proper planning. Chapter 5 talks about issues that arise specifically when the successor is a family member.

You should also give some thought to the goals and needs of the person or people who will be your successors. If you are transferring your business to your children, you will have to talk to them about the transfer to obtain their agreement. You may also have to arrange for them to learn the business before it is transferred to them. This all forms part of the time line you will work from. For example, if you think your successor is ready to take over now, you might plan differently than if your successor needs to work in your business alongside you for a year or two (or more) before he or she takes over. Chapter 6 talks about preparing your successor to take over from you and gives some practical suggestions for doing so.

If you are planning to sell your business, you may need to give some thought to how your purchasers will structure their payments. This is discussed further in Chapters 5 and 13. This might be particularly important if the people buying your business are currently employees or managers at your business. Management and employee buyouts are explored in more detail in Chapter 11.

If you are not thinking about retiring or selling at all for the time being, and anticipate holding on to your business for several more years, you should still give some thought to succession planning in case you become ill or disabled, or you die prematurely. Even if you do not take steps to begin the transfer of your business in your lifetime, you must at the very least deal with it in your will and Power of Attorney. Think of this as your emergency backup plan. This is discussed further in Chapters 16 and 17, which will talk about integrating your business planning with your personal estate planning.

Also consider that the owner of the business and the manager of the business do not have to be the same person. You may not wish to transfer both at once. By considering these two roles separately, you potentially open up even more options.

A survey done by the Canadian Federation of Independent Business in 2006 revealed that more than one third of independent business owners plan to sell or transfer their business within the next five years.[4] Thinking ahead ten years, two thirds of business owners plan to sell or pass on their businesses. That is a huge number of individual businesses changing hands in a short time span.

These changes in ownership will affect an enormous number of businesses, owners, employees, families, and assets. Despite so many business owners obviously thinking ahead about their own futures, a mere 10 percent of business owners have a formal, written succession plan. According to this study, another 38 percent have informal, unwritten plans and the remaining 52 percent do not have any plan at all for how they are going to sell or pass on their business to someone else.

Getting the Most out of This Book

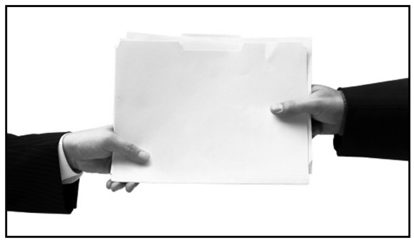
At the end of each chapter you will find a worksheet that will help you gather your thoughts about each chapter and help you apply the information to your specific situation. (The CD also includes worksheets for your use.)

You will find a Resources section on the CD that includes dozens of websites, contacts, and other materials you may wish to access if you are looking for more information on the topics covered in each chapter. All of the studies and surveys mentioned in this book are also listed in the Resources section. Please note that neither the firms and agencies listed nor their advice are recommended by the author for any individual business owner, as published information is always necessarily general. Always make sure that you consult qualified professionals to find out how general legal and tax information applies to your specific situation. Most of the resources listed are government or nonprofit agencies. However, some are privately owned businesses, so you will have to use the usual caution that you would apply any time you approach an unknown service provider.

At the end of the book, you will also find a worksheet that is designed to help you pull together all of the ideas presented to you in this book. By completing the final worksheet, you will have put together a comprehensive, step-by-step plan for the succession of your business.

[4] Doug Bruce, "SME Succession: Update," *Canadian Federation of Independent Business*, www.cfib.ca.

1
Getting Started on Your Business Succession Plan



Business succession planning means preparing for someone else to take over the ownership of your business when you retire, sell the business, or pass away. Succession planning is not a quick event; it is a process that takes months or even years. Succession planning is done by business owners who have built the business themselves, or who work in a family business built by their parents or siblings. In other words, succession planning is done by the individuals who own the business and have control over the business's future.

Succession planning is a way of making sure that what you pass on or sell to others is a viable business that can carry on successfully once you are no longer involved. You want the transition to be legally effective, free of disputes, and as tax-efficient as possible. Succession planning is a way of managing the change of ownership and the change of management.

A lot of business owners think that succession planning is a way of passing on the business to their children, but transferring to children is only one of many possibilities. The definition is broader than that and you have many more options than just passing on your business to your children. Succession planning also refers to planning to sell your business to non-family members, organizing a buyout by management or key employees, or doing a tax rollover of a company. Succession planning refers to any planned method in which you give ownership of your business to someone else. This book will talk about all of these options.

Too many business owners spend a lifetime building up and running a business but then never get around to deciding the very important question about who should take over. Many feel that they are too young to worry about it yet, and others feel that they are just too busy. Some make no plans because they simply do not know where to start. All of these are legitimate barriers to completing a business succession plan, but hopefully reading this book will be the first step towards motivating you to get started.

One of the problems with not planning how and when to leave your company to another person is that you lose the chance to look at all opportunities and ideas and choose what suits you and your business best. The failure to plan often comes back to haunt a business owner who ends up selling his or her business in a hurry because of illness, lack of communication with family members, or anxiety that a better offer might never come along.

1. What Goes into a Succession Plan?

Perhaps it would be easier for you to prepare a formal, written succession plan if you felt more familiar with the contents of that kind of plan. To show you what other business owners have included in their plans, Table 1 breaks down the various issues or topics that were included in the plans of Canadian business owners surveyed by the Canadian Federation of Independent Business.[1]

You will see that tax and legal issues were by far the most often included, possibly because many of the plans were prepared with the help of lawyers, but quite a lot of business owners also wanted to include issues such as which roles various people would play and how disputes would be resolved. It seems odd that less than half of the written plans would cover how the new owner plans to pay for acquiring the business, as that is one of the major factors addressed in how a transfer or sale of any business is structured. Obviously some written plans were much more extensive than others.

These numbers tell us only the number of items addressed in existing plans. Unfortunately, they do not tell us how many of the succession plans went as smoothly as intended or how many would have been easier if the written plans were more extensive. If you are going to develop a plan, you should try to cover every issue that may come up during the actual transition.

Table 1
What Goes into a Succession Plan

Topic or Issue	Percentage Who Included It
Tax considerations	73
Legal considerations	61
Retirement considerations	53
Required qualifications of successor	53
Purchase mechanics	49
Successor financing	45
Roles of key members of the business	45
Training or preparation	38
Monitoring of succession	31
Timetable	27
Selection process	23
Process for resolving disputes	22

[1] Doug Bruce and Derek Picard, "Succession Can Breed Success: SME Succession and Canada's Economic Prosperity," *Canadian Federation of Independent Business*, www.cfib.ca.

2. Why Should You Plan for Someone to Take over Your Business?

It is not unusual for business owners to carry on day-to-day operations without a succession plan in place. However, this does not mean that there is no good reason to put a plan in place. The business world is full of stories about businesses that were closed abruptly or sold for "fire sale" prices simply because the owner passed away or retired and had made no plans for the business to carry on. You may know of some examples from your own community. There are also plenty of stories about businesses that were passed on or sold to new owners, but the transaction was a nightmare for everyone involved. Again, this was probably due to a lack of planning ahead.

If you do not plan for a way to one day leave your business, either by transferring to someone else or by selling, you might find that you have waited too long and a decision may be forced on you. You might end up selling your business for much less than you otherwise could have because you were not prepared to act. You might even risk having your business close, leaving you with nothing to provide you with income and nothing left to sell. You might lose the chance to pass your business on to one of your children, who may assume from the fact that you never discuss your plans that you do not intend to keep the business in the family.

Something that is almost universally forgotten by business owners is that should you pass away before transferring or selling your business, the executor of your will is the person who must deal with your business. Your executor will likely not have the skills to carry on your business, or time to run it until it passes to your heirs under your will or is sold. You are pretty much setting the executor up for business failure. Because your estate has to be wound up in a reasonable time and there will be pressure from beneficiaries, your business might be sold at a fire sale price for much less than it is worth. The business might not even survive the months it will take for your will to be probated and your affairs to be wound up.

Even if you leave your business to a successor in your will and your business survives the transition from you to your executor to the successor, it is likely that the successor will have a very poor chance of success in the business if he or she has no familiarity with your company. Not many people could walk into an unfamiliar business and immediately figure out everything they need to know about employees, products, services, finances, and operations to keep the business running in good order.

Another possible scenario is that you could lose your mental capacity due to illness, injury, or aging. Mental capacity means the ability to make proper, reasonable decisions that you currently make every day as a business owner. If you were injured or became so ill that you could not run your business, what would happen to it? Are there other individuals in your company who have the legal authority and the ability to make decisions about operations, hiring or firing, contracts, suppliers, finance, and the general direction of the business as a whole? Some businesses, particularly sole proprietorships, rely very heavily on the work of one person, which makes the business extremely vulnerable if that person is suddenly put out of commission.

You also need to realize that the change of ownership of a business brings tax consequences. In fact, a lot of succession planning takes place because the current owner and the new owner both want to try to keep tax consequences to a minimum. Though it is impossible to eliminate taxes altogether, planning ahead allows you to find and use tax-efficient ways of transferring your business. Failing to plan could mean paying a lot more tax than you have to.

Finally, if you are counting on funding your retirement through dividends from the shares you will continue to hold in the business, or you are counting on a buyout over time by the new owners, you obviously have a vested interest in that business doing well in the future. If the business goes under, you jeopardize your own future financial security. Therefore it is in your own best interest to make sure your business is in the hands of competent owners who will run it successfully.

Given all of the information and warnings out there about the need to plan, why is it that so many business owners simply have not yet made a succession plan? The main reason given by business owners is that it seems to be too early to plan. You will see from Table 2 that there are other reasons given as well, some of which will no doubt sound familiar to you (note that the responses add up to more than 100 because the people surveyed were able to pick more than one answer).[2]

If you are among the 17 percent who could not find adequate advice to start planning, or the 12 percent who found succession planning too complex, reading this book should go a long way towards getting you started on the right track. If you are among the 60 percent who think it is too early to start planning, hopefully this book will help you realize that even if you do not begin an actual transfer or sale yet, it is never too early to start thinking about your future and that of your business.

In the event that you are not yet persuaded of the benefits of succession planning for your business, you might find it interesting to look at the comments made by business owners who have recently transferred their business to someone else through a planned succession, as shown in Table 3.[3] An overwhelming majority of the people who responded said that the succession planning for their transaction had assisted in providing for their family's future. That shows that a lot of people were happy that they went through the planning procedures.

Large majorities of these former business owners also agreed that the planning had minimized their future tax liability, provided financial stability for the business, and maintained harmony with family members and employees. Surely these are exactly the results any business owner would want when transferring his or her business. If the items listed in Table 3 are results you want for yourself and your business, it is time for you to start your business succession plan.

Table 2
Reasons Why Business Owners Have Not Made a Succession Plan

Reasons Why There Is No Succession Plan in Place	Percentage Who Included It
Too early to plan for succession	60
No time to deal with the issue	28
Can't find adequate advice or tools to start	17
Too complex	12
Other	11
Don't want to think about leaving	8
Conflict with family and/or employees	3

[2] Ibid.

[3] Ibid.

Table 3
Comments from People Who Were Successful at Succession Planning

Comments	Agreed	No Opinion	Disagreed
Assisted in providing for family's future	82	16	2
Minimized future tax liability	76	20	4
Provided financial stability to business	75	22	3
Maintained family harmony	73	22	5
Prepared successor for the future	72	24	4
Maintained harmony with employees	72	26	3
Increased value of business	64	28	8
Improved financial standing of business	56	35	9

3. Succession Planning Should Be Part of Your Overall Financial Plan

Business succession planning is part of your overall personal financial plan. This means that your business, any paperwork such as buy-sell agreements, your personal finances, and your personal will all have to work together. You do not want any one part of your financial picture to contradict another part, as the whole point of the planning is to ensure that things go smoothly. The business succession plan should not be done in isolation from the rest of your personal financial planning.

Some of the words that business owners have applied to the business succession concept are "intimidating," "complex,"and "overwhelming." It is certainly easy to see how business owners, who are already busy people, find the process too much to handle. While it is true that succession planning is a lengthy, detailed process, not everything has to be done at the same time; in fact, many people like to finish one aspect before starting on the next. For example, you might complete all of the planning and paperwork for the succession of your business and only look at your personal will and power of attorney after that is completed. Taking one step at a time is fine. As long as everything does get finished and all of the components work together, it does not matter which ones are done first. Breaking it down into smaller pieces might help you to avoid the feeling of being overwhelmed by a huge task.

It is a good idea to acknowledge that completing your business succession plan and personal financial plan is not going to happen overnight. If you think otherwise, you are bound to become frustrated and impatient with the planning. Succession planning is not really about completing a quick sale transaction. The vast majority of business owners find it most useful to plan well in advance for a transfer that will take place at a predetermined time. Leave yourself time to think things over and look around you at possibilities. Allow yourself reasonable time so that you do not feel pressured and frustrated.

4. Consulting with Lawyers and Accountants

Keep in mind that to put your succession ideas into action, depending on the type, size, and value of the business and the complexity of your plans, you will likely have to consult an accountant and/or a lawyer who specializes in business planning. You may also need the services of a financial advisor, banker, or insurance representative. You should use the information in this book to shape a general idea of how you want to proceed. Before going ahead with your idea, you will more than likely want to sit down with an experienced accountant who will be able to apply your general plan to your specific company. It is essential that you know how tax rules in particular will affect your succession plan.

Most business owners rely on professional advisors for help when selling or transferring their businesses. Business owners rely on accountants to get tax information and to look for strategies to reduce taxes. They rely on lawyers to get legal information and to understand the implications of succession ideas on themselves, their families, and the business itself. They rely on bankers when their succession plan needs some financial help. The point at which you approach advisors depends on your specific circumstances and plans, but generally you should seek advice in the early stages when you are simply looking at your options. You will then find that you will continue to use that advice in the later stages when you know exactly what you require and want to do to set things in motion.

Table 4 is based on figures released by the Canadian Federation of Independent Business. It shows what percentage of business owners who have a succession plan in place (either formal or informal) relied on various professionals for information and assistance.[4] Perhaps Table 4 will give you ideas for sources you can access yourself.

Reading general information such as this book is very valuable to give you a solid background and to help you formulate a plan, but it can never replace a one-on-one consultation with a professional who can answer your specific questions. Knowing the information in this book will put you in a position to better understand and use the advice your advisors will give you. It will also reduce the amount of time your advisors will have to spend on teaching you the basic principles of estate planning and taxation, and therefore will reduce the amount you pay in professional fees.

For a breakdown of the professional services that you as a business owner can expect to receive from accountants, lawyers, bankers, and insurance agents (and a description of the

Table 4
Professionals Consulted by Other Business Owners

Type of Professional	Percentage Who Consulted That Type of Professional
Accountant	91
Lawyer	67
Informal sources (e.g., business associates, key employees, possible successors, friends, family)	63
Bank	42
Financial advisor	40
Business association	39
Insurance broker	38
Business Development Bank of Canada	12

[4] Doug Bruce, "SME Succession: Update," *Canadian Federation of Independent Business*, www.cfib.ca.

various specialties of accountants), you would likely find it useful to look at the website for the Canada-Ontario Business Service Centre, particularly the section entitled "Selecting Professional Services." (The URL is included in the Resources file on the CD.)

To find an accountant in your area, try contacting the Chartered Accountants of Canada (CA), Certified Management Accountants (CMA), and/or Certified General Accountants Association of Canada (CGA). (Contact information is included in the Resources file on the CD.)

To find a lawyer in your area, try contacting one of the lawyer referral services shown in the Resources file on the CD. (Note that New Brunswick and Saskatchewan do not have lawyer referral services.) All of these referral services (except Ontario) will provide you with the names of lawyers free of charge. If you use the Internet to locate a lawyer, beware of services that charge money to the lawyers who are listed there, as they often do not screen the people they list. To ensure that you only contact reliable, trustworthy sources, each of the lawyer referral lines mentioned in the Resources section is run by the provincial or territorial law society, bar association, or nonprofit public legal education society.

As a general tip, the very best way to find a great lawyer, banker, or accountant is through word of mouth. Ask for referrals from friends and other business owners who have gone through their own business succession planning. Do not bother asking people for the name of the lawyer who did their divorce or the accountant who prepares their personal taxes, because those are not the tasks you need the lawyer or accountant to do for you. Remember that lawyers and accountants have specialties. Ask the people you meet through networking (i.e., your local Chamber of Commerce or business owners association) whether they would recommend that you talk to the person they used for succession planning. Most people will not send a friend or business associate to someone who was not genuinely helpful and knowledgeable.

5. Capital Gains Tax

Throughout this book, you will see several mentions of *capital gains tax*. Because capital gains tax is such a big part of the consequences of transferring a business, it is important that you have a basic understanding of how this tax works in order to get the most out of the planning and tax sections of this book and of the professional advice you seek out.

This section will give you a basic explanation of what capital gains tax is. If you would like to read more detailed information about it, Canada Revenue Agency (CRA) has published a guide called "T4037 — Capital Gains." This, along with other useful guides, is available on CRA's website, where you can read, download, or print the guide for free. The guide was written to be used by people who do not have professional training with tax matters. The link to the CRA website can be found in the Resources file on the CD.

Certain kinds of assets are considered for tax purposes to be *capital property*. This includes several kinds of assets, including land. For the purposes of this discussion, if you are the owner of an incorporated business, the items of capital property to be most concerned with are your shares of your business corporation. Shares of *private corporations* (i.e., businesses owned by one or more individuals and not listed on a public stock exchange) are considered by CRA to be capital property for tax purposes.

The day you first obtain the shares of your business, they have a value. The value might be zero if you started your business from scratch, or the value might be higher if you bought your business, already fully operational, from someone else. Whatever the dollar amount, the value of your shares of your business on the day you acquired them is referred to as the *adjusted cost base* (ACB) of those shares.

Over time, as you put work, effort, and resources into your business, it grows and becomes profitable. It accumulates assets. As it grows, the value of the business increases. The value may include the land, buildings, equipment, and inventory owned by the business as well as intangible assets such as goodwill and reputation (see Chapter 13 for information about how to put a dollar amount on your business). Because your business shares are capital property, and because they have gained in value while you owned them, this is referred to as a *capital gain*.

When the time comes to sell or transfer your business, you will have to pay tax based on how much your business has increased in value while you owned it. Half of the capital gain increase is taxable and is reported as income on your personal income tax return. This tax is the *capital gains tax*.

As an example, look at the following case of Robert, who started a company from scratch. Please note that this is a very simplified example for the purpose of illustrating capital gains tax. In this example, "the business" includes the shares and everything owned by the business, and the example does not address any specific deduction that might be available.

This illustrates one of the main reasons why business succession planning can be so useful; since you know you are going to have to pay capital gains tax when you sell or transfer, you can plan ahead to use strategies that will give you deductions or exemptions you can use to reduce your tax liability. In this book, several chapters discuss procedures that might be applicable to your situation.

Even business owners who operate as sole proprietors must consider capital gains. While they do not have to worry about the increase in value of shares, as there are no shares, they do still have to consider the increase in value of assets that are used in the business. For example, a sole proprietor may have bought a building in which he or she runs the business. When the business changes hands and that building is disposed of, there is still a capital gain to be considered.

On the day Robert first started up Robert Enterprises Inc., the shares were worth nothing because he had no equipment, inventory, or customers yet. His adjusted cost base was therefore zero. He made a success of the business and many years later he decided to sell the company to Jason. They struck a deal and Robert Enterprises Inc. was sold to Jason for $300,000.

During the time that Robert owned the business, it increased in value from zero to $300,000. Therefore, Robert's capital gain was $300,000. Half of that amount, or $150,000, is subject to tax. This does not mean that Robert pays $150,000 in tax. It means that he includes the $150,000 in his reported personal income for that year. He then tries to reduce how much tax he pays on it by using deductions and exemptions as each person does every year on his or her tax returns.

Jason's adjusted cost base is $300,000 because that is how much the business was worth when he bought it. In the future, when Jason sells or transfers the company to someone else, he will pay tax based on the increase in value higher than $300,000.

6. Shareholders Agreements

Many businesses have only one owner so there is unlikely to be a shareholders agreement (also sometimes called a *buy-sell agreement*). Even in cases in which there is more than one owner, many business owners still have not bothered to prepare one of these very useful documents. If there is a shareholders agreement already in place for your company, review it to see whether there are arrangements already in place for the transfer of your shares of the business to someone else.

For example, suppose two brothers, who own and operate a computer-consulting firm, made a shareholders agreement when they set up their business. In the agreement, which they both signed, they each stated that should either of them want to sell their shares of the company, the other brother would have the right of first refusal to buy his brother's shares. They both agreed to this arrangement knowing that if the other one wanted to sell, the remaining brother wanted to have the option of continuing to run the business without a new, unknown partner.

There could be other, similar restrictions in place for your business. If you have not looked at your shareholders agreement in some time, you may have forgotten what those restrictions are. Often, business owners state that they have not read their agreement in 20 years or more because they simply have had no reason to review it. Before you get very far into your planning, you should check to see whether your shareholders agreement, if you have one, places any restrictions on your freedom to do what you want with your shares of the business.

The second way a shareholders agreement comes into play is at the time your company is transferred to a new owner. Unless your business is being sold outright for cash, you are likely still to be involved after the transfer as a shareholder of one sort or another. For example, if you are using an estate freeze, you will own preferred shares in the business after ownership is transferred. (See Chapter 9 for more information on estate freezes.) Or, if you are structuring a management buyout, your shares may be purchased by the buyers over a long period of time so that the ownership gradually transfers from you to someone else. While there will be a sales contract or other transfer documents to set out the terms of the sale itself, there should also be a shareholders agreement that sets out how the shares will be dealt with by the new business owners.

Worksheet 1
Goals for Succession Planning

You can use Worksheet 1 to gather your thoughts about what you would like and expect to achieve by setting up a business succession plan. For each of the following sentences, answer “yes” or “no.” For your convenience, this worksheet is also available on the CD.

Goals for Succession Planning	**Does This Apply to You?**
To provide for my family’s financial future.	
To allow me to retire comfortably.	
To make sure my business stays in the family.	
To pass on my business to one or more of my children.	
To make sure that what I’ve built during my lifetime is carried on.	
To maintain family harmony.	
To provide one or more of my children with a means of making a living.	
To sell or transfer my existing business so I can move on to open another business.	
To achieve peace of mind about the future.	
To feel organized and in control.	
To have something in place for emergencies even though I’m not ready to retire or sell.	
To learn about options I can use for planning in the future when I’m ready.	
To avoid family fights after I pass away.	
To learn ways to avoid paying too much tax.	