CIBC PRIVATE WEALTH

ONE-TO-ONE INSIGHTS

# JAMIE GOLOMBEK'S TIPS FOR BUSINESS TRANSITION PLANNING

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As a Canadian small business owner, you've spent your career nurturing its success. But maybe it's time for a new challenge and you're thinking about how to pass the business onto the next generation.

"Even if you're not looking to retire, transition planning helps set the stage for your business to be transitioned to the new owners and may help to reduce taxes," says Jamie Golombek, Managing Director of Tax and Estate Planning at CIBC Private Wealth. "It's important to think ahead and carefully consider how to transfer your small business." Jamie has some quick tips for small business transition planning. Let's take a look.

## Transferring to family members

Perhaps the most obvious transition plan for a family business is to pass it onto the next generation. Since most small businesses of any significant size in Canada are structured as corporations, we'll focus mainly on sale of the corporate shares to the next generation.

## Sale of shares

In many family transition plans, the business is sold to the next generation since the proceeds from the sale represent a lifetime of wealth accumulation for the owner who generally needs those funds to fund their living expenses after retiring from the business. In this case, you'll be deemed to have disposed of your shares for proceeds equal to fair market value (FMV). The difference between the FMV and your adjusted cost base (ACB) or tax cost of your shares will be a capital gain, of which 50% is taxable at your marginal tax rate.

From a tax perspective, you have to be careful when structuring a sale to certain family members, such as your children, since you will be deemed to receive proceeds equal to the FMV of the shares sold, no matter what price you assign to the shares. The ACB for the family member, however, will generally be limited to the amount paid for the shares, which can result in double taxation.

That's why it's recommended that you get a third-party valuation prepared to substantiate the FMV since the Canada Revenue Agency (CRA) or Revenue Québec would be especially likely to review the transaction, given there would be no arm's length party on the other side of the share transfer to validate the FMV used.

## The lifetime capital gains exemption

The lifetime capital gains exemption (LCGE) may be available to shelter up to $913,630 of capital gains on the sale of qualified small business corporation (QSBC) shares in 2022[1]. QSBC shares are shares of a Canadian-controlled private corporation in which 90% or more of the value of corporate assets are used in an active business in Canada at the date of sale or transfer. Also, for at least two years prior to the disposition of QSBC shares, more than 50% of the corporation's assets must have been used in an active business in Canada. This means that one of the most important steps in your transition plan is to monitor passive investments made through your small business corporation that could disqualify you from claiming the LCGE.

Another important step in the transition planning process is to ensure that the corporation's shares are properly structured in advance to permit multiple family members to access their own LCGE. For example, suppose the capital gain on the shares is $1.8 million and you wish to transfer the business to your kids. Ideally both you and your spouse or partner, if applicable, would each already own 50% of the shares. This would allow each of you to claim the LCGE. If this isn't currently the case, it may be worth reorganizing the share capital of your operating company to allow future access to multiple exemptions upon ultimate gift, sale, or even death.

## Proceeds in cash or debt

Once the FMV of the shares has been established, the next question is how you will be paid: cash or debt? Naturally, if the successor has the cash, a payment allows you to invest that cash to fund your retirement.

Debt may also be a handy tax deferral mechanism. For example, if you take back debt on a sale to your child or grandchild, perhaps in the form of a promissory note, you have the ability to defer paying tax on the capital gain realized upon the sale of the shares immediately and recognize it over up to ten years.

### Are you ready?

More information is available in the CIBC report, "Business Transition Planning: Unleashing the tax opportunities!" Contact us to learn more about how you can prepare to pass your small business to the next generation. And be sure to discuss these rules with your legal and tax advisors before implementing your plan.

[1] The LCGE is increased to $1 million for qualified farm or fishing property, which includes shares of a Canadian-controlled private corporation if more than 50% of the fair market value of the property owned by the corporation was attributable to property used principally in a farming or fishing business carried on in Canada.