

BMO Farm Succession Planning Seminar

Key Legal Considerations

March 26, 2003

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Areas of Specialization

**Family and Owner-Managed Businesses
Estate, Tax and Succession Planning
Wills, Estates, Trusts and Estate Disputes
Real Estate and Land Development**

A. INTRODUCTION

1. Top Mistakes in Estate and Succession Planning:

- failure to plan and sudden illness or death strikes!
- joint tenancy traps
- conflict in family due to failure to communicate about your plan
- tax grabs by governments: not minimizing income taxes and probate fees
- not having proper legal documents in place can lead to expensive litigation
- failing to have a detailed understanding how existing laws and legal agreements affect your estate and succession plan: know your Wills and Powers of Attorney, shareholders' agreement, bank loan security, how you hold title to assets, the implications of the Family Law Act, creditor rights.

2. What is estate and succession planning?

- Estate planning
 - is the planning process that we all must undertake to achieve the following goals:
 - maximize our wealth and accumulation of assets, which involves minimizing taxes during lifetime
 - ensure that on our passing our hard-earned assets are passed on to our beneficiaries to meet their needs with minimum tax consequences and government interference and minimum family stress and conflict
 - minimize government interference and family stress in the case of incapacity
- Succession planning
 - is an additional aspect of the estate planning process that all farm and business owners must undertake to ensure the orderly transition of

ownership of the farm or business in the event of the owner's incapacity or death or on a sale to a third party

- the process is even more difficult for family farms and businesses in light of the additional complexities involved, including:
 - sibling rivalry
 - founder not wanting to relinquish control
 - children inside and outside of the business
 - family business succession is a specialty
 - CAFÉ, The Canadian Association of Family Enterprise (some large farm/producers are members)

B. FACTORS TO CONSIDER

- you might plan for succession if you have a son or daughter working in the business who is capable of taking over:
 - consider the pros and cons of planning by Will vs. selling or transferring ownership to your children during your life
 - are you selling or gifting the business or property?
 - obtain a proper valuation to ensure a fair price is used for either purpose
 - consider joining an organization whose goal is to help family businesses succeed in succession, the Canadian Association of Family Enterprise, known as CAFÉ
 - Do you have other children not in the business? If so, do you have sufficient assets to leave to them in your Will to balance things out? Are you still insurable?
- Otherwise you will be contemplating a sale to a third party:
 - consider retaining a consultant to improve the bottom line and sale price
 - as above, obtain a proper valuation

Keep in Mind:

- **we are living longer**
- **cost of retirement living/health care**

- **do you have sufficient capital to consider an estate freeze and pass on future growth of assets/business to next generation and quantify capital gains tax on death (or eliminate it)?**

- **have you utilized the capital gain exemption?**

- **if no longer active in business, cannot justify large salaries: how to ensure sufficient income for needs?**

- **special needs of spouse or children with incapacity, whether mental, physical or economic**

- **special considerations if second spouse and children from prior marriage (Major problem area)**

- **dysfunctional family members**

- **ready to relinquish control of business or investments?**

- **concerns of Family Law Act claims by spouse or children's spouses?**

- **concerns of claims from creditors of children?**

C. KEYS TO SUCCESS

- **Undertake a comprehensive review of your affairs by a lawyer and accountant who specialize in estate and succession planning for owners of family farms and businesses**

- Involve other specialists in the field as required, such as insurance, investment, banking, trust company
- Undertake planning while you are young and healthy, with time on your side
- Update your plan regularly, at least every 5 years

D. HOW TO MINIMIZE GOVERNMENT TAX GRAB?

- tax legislation framework
 - no gift tax, but income tax consequences such as capital gains tax and attribution rules
 - no inheritance or estate tax, but capital gains tax and probate fees
- Strategies:
 - Reducing income tax during life and on death
 - You need a good tax accountant like Doug to do tax planning
 - Your lawyer assists the tax accountant by preparing the necessary legal documentation to implement the plan, including reorganizing the structure of the business, incorporating a corporation, drafting shareholders' agreements, trusts, wills and powers of attorney
 - Reduce or eliminate probate fees, which are a provincial tax of a maximum of 1.5% of the value of your estate

HOW TO MINIMIZE PROBATE FEES

I spend a lot of time with clients on planning to minimize or eliminate probate fees on death. Strategies include:

- *Inter vivos gifting (could be shares, investments)*
 - pro

- gives ownership and control to donee
- avoids probate fees on your death
- con
 - loss of ownership and control (irreversible if your circumstances change)
 - could trigger capital gains tax/attribution rules
 - creditor and Family Law Act concerns

example: joint tenancy (gifting of a half interest)

- pro:
 - avoids probate fees
 - great for simple plans for spouses (as with designated beneficiary of spouse in insurance and RRSP)
- con:
 - it is partial gifting so above problems apply
 - not so great with kids: can result in adverse tax consequences: such as parent transferring house into title with child who already has a principal residence
 - works outside of will so can frustrate provisions

of will:

Recent example of problems with joint tenancy:

Only assets were joint and insurance had second spouse designated as beneficiary so will of client leaving bulk of estate to child from prior marriage was insolvent. Second wife got everything

- ***Inter vivos trusts:***

- pro
 - flexible and you retain control over assets

- allows you to sprinkle income and/or capital among various beneficiaries at a later date
- provides more protection than gifting from creditors and Family Law Act claims
- con
- expensive and complex to set up
- can trigger capital gains tax
- example: alter ego trusts and joint spousal trusts
 - pro: if over age 65 can transfer property to trust without triggering capital gains and thus avoid probate fees depending on how much of your assets are put in the trust

Example of Savings Using Alter Ego Trust:

Assets:

i. farming assets owned outside of a corporation having a value of \$1,000,000 (and no multiple wills)

ii. other assets such as stocks, GICs, Bonds value of \$200,000

- if no trust used, probate fees are: \$17,500

- if all assets are transferred to alter ego trust
probate fees are: nil

- savings: \$17,500

- con: - expensive to set up and complex

- must pay tax consulting and legal costs now to save probate fees when you die

- (fees can range to \$2,500 for each of legal and tax consulting for a total cost of approximately \$4,000-\$5,000)

-it is uncertainty of how long you will live

-you may not think it is worthwhile when you take into account present value of savings vs. up front costs

- many clients have decided not to proceed

- ***Multiple Wills***

Q: When are Multiple Wills Useful in Reducing Probate Fees?

A: When you own shares in a private farm corporation or other corporation and/or substantial personal property such as equipment owned outside of a corporation

Q: What are Multiple Wills?

A: Recent legal decision of the Court permits two wills are prepared for each client

- the first is restricted to assets that can be transferred without probate being required, i.e., shares in private farm corporations or holding companies and personal property such as equipment owned outside of a corporation
- the second is the main will that deals with all other assets.
- Only the second will must be probated, thus you save 1.5% of the value of the shares in your corporation and personal property
- in my view all owners of private corporations should have multiple wills
- pro
 - can avoid substantial probate fees on your death

Example of Savings Using Multiple Wills:

Assets:

i. farming corporation having a value of \$1,000,000

ii. other assets such as stocks, GICs, Bonds value of \$200,000

- if only one will, probate fees are: **\$17,500**

- if multiple wills, probate fees are: **2,500**

- savings: **\$15,000**

- con
 - increased legal expenses, probably no more than \$1,000 (more than offset by probate fee savings!)
 - more complex

E. USE OF SHAREHOLDER AGREEMENTS

- I consider it mandatory in private corporations where multiple shareholders
- creates market for shares and cash for estate on death and/or incapacity
- avoids you having as a new shareholder the estate of a deceased shareholder
- ensures operations continue in orderly fashion in the case of an emergency
- ***Life Insurance***
 - to fund buy-outs in Shareholder Agreements triggered during life or upon death
 - to create a larger estate for your family to even things up among children
 - to pay any capital gains tax liability in the estate and thereby reduce or eliminate the need for your estate to sell all or part of your business or other investments at possibly poor prices

F. POWERS OF ATTORNEY: *Planning for Incapacity*

- **Power of Attorney for Property**
 - be aware conflict of interest when appoint your spouse or children if they are your capital beneficiaries
 - I typically recommend your spouse, with all children acting jointly as alternates to avoid disputes
 - professional/corporate attorneys:
 - **Recent Example**: corporate attorney should be considered where siblings do not get along and/or live far apart. Son took care of mother for past several years in her home and he did banking with her signing cheques. Mother had appointed son and one of two daughters as attorneys. When mother moved into nursing home trouble flew. Meetings with 3 lawyers for three children. Months later still couldn't agree on care costs or banking details. Solution: appoint either all children jointly, or where trouble is anticipated, consider a corporate appointment
 - keep originals in safekeeping as risk for misuse

- can be used by attorneys for limited estate planning for incapacitated donor, but best to do planning while capable
- **Power of Attorney for Personal Care**
 - everyone should have one
 - again, I typically recommend your spouse, with all children acting jointly as alternates to avoid disputes
 - include "Living Will"

G. LAST WILL AND TESTAMENT: *Planning for death*

- essential that it be drafted properly by a specialist
- I see poorly drafted wills and estate/succession plans constantly and it feeds my estate dispute side of the practice
- many lawyers draft wills, few specialize in the area
- **executors/trustees**
 - who you should appoint will depend on the facts, i.e., whether outright distribution or a trust
 - if a trust will, I often recommend a team of 3, depending on the family dynamics
- **outright gifts**
 - to spouse: tax rollover but loss of control may be an issue – see trusts
 - to children:
 - many farm and business clients leave the farm/business property/shares to the son/daughter who works it, and other assets to the non-farming/non-business children
 - may not be sufficient other assets to equate inheritance, and no longer insurable
 - **Recent Example:** Parents left farm to son in their wills, had already transferred the quota and equipment to him during life. All cash and other assets were left equally to their two daughters. Son's inheritance much greater than daughters'.

- **testamentary trusts:**
 - **pro**
 - **tax savings**
 - **trust for spouse (rollover for tax purposes, but can taint if wish to trigger some gains) (Doug)**
 - **trust for children (income splitting possible) (Doug)**
 - **tax savings due to trust having own marginal rate**
 - **protect capital for children**
 - **set up a trust for spouse, she/he gets the income for life then capital goes to children on her/his passing**
 - **capital protected even if spouse remarries or lives common law after you pass away**
 - **this is a very important concern for many of my clients**
- **spousal election**
 - **a spouse has 6 months from date of death to elect to either take under the will and insurance policies or take an equalization payment as on divorce**
 - **comes into play if use a spousal trust or if spouse does not receive entire estate**
 - **Recent Example: wife died leaving husband life interest in the farmhouse and she left all other assets to their two adult children. It took several months to settle the estate as husband was very upset.**
- **probating the Will**
 - **when is probate required?**
 - **required if assets are of types where institutions require probate before they will transfer to estate, such as stocks, bonds, large bank accounts**
 - **generally not required for assets held jointly**
 - **as noted above, not required if all assets in a farm corporation and you have Multiple Wills or if all assets are held by an alter ego or joint spousal trust**

Summary:

- feel free to see me after the seminar or contact me by telephone or email with any specific questions you may have

- I am please to offer a free initial consultation either at my office or your home

Note: these materials are a summary of important legal issues relating to estate and succession planning and are not intended, nor should they be relied upon, as legal advice. The matters discussed are complex. The points of view expressed and actions noted may change when applied to each client's particular circumstances. I recommend that you retain expert legal advice prior to proceeding with planning.