Business owner insight: The recipe for succession planning

As a business owner and entrepreneur you have complex needs. Your business provides you and your family with financial security and it's a legacy that you may want to pass on to loved ones. Its success is also fundamental to the overall business and potential shareholders.

With this in mind, have you created a strong succession plan to address your transition from the business to your next adventure? Even if your departure isn't imminent, it pays to be proactive. A detailed succession plan will help to maximize your business's value and ensure that all stakeholders are satisfied with the outcome. Let's look at some important issues you'll need to address.

Identify key stakeholders

The first step is to understand the scope of succession planning: both who and what are involved. Breaking down the key stakeholders will make it easier to manage. The players may include your family, shareholders and the business itself. With a comprehensive and integrated succession plan, you can address the needs of each stakeholder. Consider the following:

- **Family members** may have certain expectations or wishes that may have not yet been expressed
- **Shareholders** expect to maximize the value of the business at sale
- **The business** needs a strong leader who understands and can implement the next steps for growth

Through the planning process you also have the opportunity to revisit your net worth position and future cash-flow requirements. It's important to have an updated financial plan to address your needs for the next stage of your life.

Identify the right exit option

Another critical part of succession planning is to identify what you want to do with your business. That could mean transitioning the business within your family or selling it to a third party. If you plan to pass the business on to a family member(s), you'll need to create a successor development plan. If you decide to sell to a third party, look to a strategic partner or employee(s) to maintain the business's viability.

"It's important to identify the right exit plan early on. It may be that an internal succession to a passionate family member is the best option. Conversely, unlocking the value of the business through a sale to a third party can also be a valid option. A third party can bring synergies and access to new markets, new ways of doing things and fresh capital," says Sean Foran, Managing Director, Business Transition Planning at CIBC.

Of course, you must also assess your business accurately in order to provide a fair valuation for the transition process. Our team of experts can help you with this.

What can happen if you don't plan?

"As a business owner, you have a lot at stake. You have your family who have come to rely on the lifestyle the business provides and then there are your customers. If we don't plan proactively for all that, we can leave the business, the family and the shareholders in a very disadvantaged position," says Foran. Issues that may arise include:

- Family concerns are left unsaid, which leads to misunder standings and discord

- Top employees leave if they doubt the future stability of the business
- You're more likely to miss the optimal time to sell the business
- You may not know how to react to an unsolicited approach
- Strengths and opportunities may not be properly articulated
- You're unprepared for the buyer's due diligence exercise

Open discussions with your family and early planning can help mitigate these concerns.

Introducing the CIBC Business Transition Planning Checklist

The CIBC Business Transition Planning Checklist helps you proactively prepare for your move away from your business. The checklist covers areas such as goals, taxation and communications, and is an excellent tool for you to begin the succession planning process.

For more information about business succession planning, watch Business Owner Insight: Be Proactive—The Secret to Succession Planning and review the CIBC Business Transition Planning Checklist.

An early start to proactive succession planning will help you maximize the value of your business when the time, buyer and terms are right. We work with the CIBC Business Transition Planning Team and Wealth Strategies Group to help you ensure a successful—and profitable—business transition. Call us anytime to discuss.

Tax planning with TFSAs

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The tax-free Savings Account (TFSA) has been available to Canadians since 2009. According to the government, the TFSA is a "flexible, registered general-purpose savings vehicle that allows Canadians to earn tax-free investment income to more easily meet lifetime savings needs."

Are you taking full advantage of the TFSA?

The basics

If you are a Canadian resident, at least 18 years old and hold a social insurance number, you can open a TFSA. You can also set up as many TFSAs as you want.

The total amount you can contribute is based on your TFSA contribution room. If you were at least 18 years old in 2009 and a Canadian resident, you have accumulated TFSA contribution room each year since then[1]. This room continues to add up and unused room is carried forward indefinitely.

Also, any TFSA withdrawals in a particular year will generally be added to your contribution room for the following year. This is a significant difference from Registered Retirement Savings Plan (RRSP) rules. It means you can withdraw TFSA funds and re-contribute an equivalent amount as of the next taxation year (to avoid potential penalties, confirm timing with a tax advisor before re-contributing).

Unlike RRSPs, contributions to a TFSA are made from after-tax funds—tax is pre-paid—and aren't tax deductible. The advantage is that any income and gains on investments held within a TFSA isn't taxed either while inside the TFSA or at withdrawal[2].

Let's look at some financial planning opportunities the TFSA presents.

Developing a savings plan

You've likely heard the phrase 'a rainy-day fund.' It's money you set aside in case you need to pay for an unexpected event, like a leaky roof. Rather than leaving your rainy-day fund in highly-taxed investments, why not take advantage of the TFSA to build your savings? With a TFSA, funds can be tax-effectively maintained since all income and capital gains earned are tax-free.

This can be particularly beneficial for highly-taxed income, like interest from a high-interest savings investment or money market mutual fund.

Tax effective planning: TFSA or RRSP?

How do you choose between contributing to a TFSA or an RRSP?

The chart below compares the after-tax accumulation over 20 years of $5,000 of employment or business income earned by an individual, invested through a TFSA or an RRSP. It assumes a marginal tax rate of 40% and 5% growth on investments.

	TFSA	RRSP
Pre-tax income	$5,000	$5,000
Tax (40%)	(2,000)	n/a
Net Contribution	$3,000	$5,000
Amount in 20 yrs, with 5% growth	7,960	13,266
Tax upon withdrawal (40%)	n/a	(5,306)
Net cash	$7,960	$7,960

- **TFSA scenario:**
  The $5,000 is taxed upfront at your marginal tax rate the after-tax amount of $3,000 is contributed to your TFSA
  Earnings and growth are inside the TFSA and not taxed during the accumulation phase or upon withdrawal
  The after-tax value after 20 years is $7,960

- **RRSP scenario:**
  You don't pay tax immediately on the $5,000 because you may claim a deduction for your contributions
  The $5,000 invested in your RRSP grows to $13,266 and is taxed upon withdrawal in 20 years at your marginal tax rate
  You net $7,960

In this example, the two plans produce the same results. This only holds true if your tax rate upon contribution is the same as your tax rate upon withdrawal.

RRSPs make more sense when your tax rate upon withdrawal is expected to be lower than your tax rate upon original contribution. Conversely, TFSAs will work out better if your tax rate is higher upon withdrawal than it was when you contributed. This includes the effect of RRSP withdrawals on benefits such as the Guaranteed Income Supplement or Old Age Security, which are clawed back based on income.

Since TFSAs are much more flexible, the math doesn't tell the full story. For example, the savings you withdraw can be re-contributed to your TFSA later on. You can't do this with RRSPs.

Retirement planning

TFSAs can also help if you can't contribute to an RRSP. For instance, if you are a registered pension plan member through your employer, you may find your ability to contribute to an RRSP severely limited by the pension adjustment.

Similarly, if you don't have any earned income or you are over 71, you may find the TFSA a useful way to sock away extra funds on a tax-free basis for savings or retirement.

Income splitting with spouse or common-law partner and kids (over 18)

Normally, the attribution rules in the Income Tax Act block attempts at splitting either income or capital gains between spouses or common-law partners. This is done by attributing such income or gains back to the original spouse or partner.

The TFSA rules provide a specific exception to the attribution rules. The rules won't apply to any income or gains earned in a TFSA from a spouse or partner's gift to the TFSA holder. This applies as long as the TFSA holder contributes to their own TFSA. This is a good opportunity for a high income spouse or partner to give an amount up to the annual contribution limit, to a lower income or zero income spouse or partner who can contribute to a TFSA.

Also, if you've got kids who are at least 18 years of age, you can consider giving them an amount up to their contribution limit annually to contribute to their own TFSAs. You cannot set up a TFSA jointly or "in trust" for a child.

To review Jamie's full article, click here.

Contact us to discuss how a TFSA could complement your existing saving and investment plans.

1 *If you were 18 and have resided in Canada since at least 2009 and have never contributed to a TFSA, in 2017 you could contribute a total of $52,000. This includes $5,000 of TFSA contribution room for 2009 to 2012, $5,500 for 2013 and 2014, $10,000 for 2015 and $5,500 for 2016 and 2017.*

2 *This is assuming you are not in an over-contribution position.*