



## Meet the Smith Family

Transitioning your family business requires a thoughtful, step-by-step approach. As part of your overall estate plan, it is important to think about where your business is now and what you envision for the future. The case study below brings to life how transition planning might work for a family with diverse needs and interests.

### Case Study: Edward And Caterina Smith

Edward Smith is a 75-year-old business owner who has been married to his wife Caterina (74 years old) for 40 years, and they have three adult children. They live in Ontario.

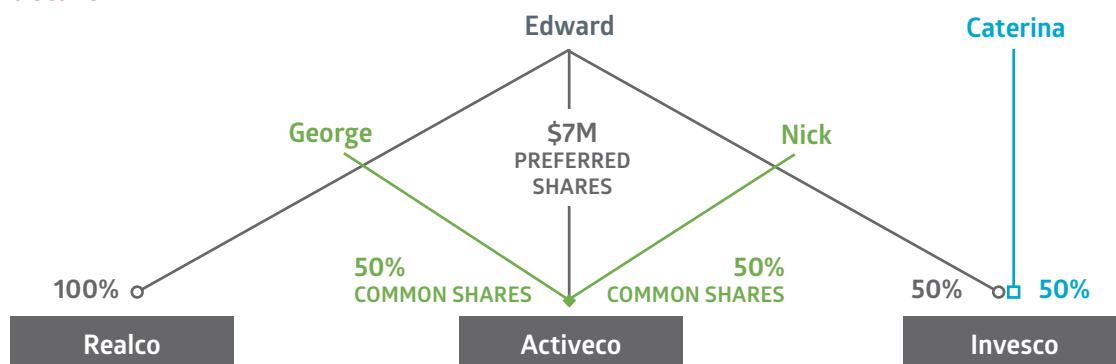
- Edward completed an estate freeze a few years ago and owns \$7 million of preferred shares in his family business ("Activeco"). His two sons (35-year-old George and 37-year-old Nick), each own a 50% interest in the common shares of the business and are both actively engaged in management roles for the business.
- Edward owns a 100% interest in a real estate corporation ("Realco"). It is comprised of a commercial building (used to run the active business) with a fair market value of \$4 million and a cost basis of \$1 million.
- Edward owns a 50% interest in an investment corporation ("Invesco"), with professional investment management provided by CIBC Wood Gundy. The corporation has a fair market value (FMV) of \$2 million (based on a total fair market value (FMV) of \$4 million) and a cost basis of \$1 million (based on a total cost basis of \$2 million). His wife, Caterina owns the remaining 50% interest.

- Edward and Caterina jointly own their primary residence valued at \$2 million.
- Caterina is in poor health and in early stages of dementia and requires regular care.
- Edward and Caterina have one daughter, Juliana, not involved in the family business.

#### Client Objectives

1. Transfer ownership of the business to George and Nick.
2. Provide a guaranteed income stream to Caterina.
3. Provide an equitable ('not equal') estate value to Juliana.

### Current Structure



## Step 1: Will Planning

Edward has mirror-image wills with his wife Caterina that were last updated 10 years ago. Under the direction of the wills, all property passes to the surviving spouse. The rules surrounding taxation on death can be complex, particularly for business owners. As a result, the estate can benefit from a knowledgeable trustee, such as a **CIBC Senior Trust and Estate Consultant**, which can help explore the available post-mortem planning options.

### Planning Recommendations

- Wills should generally be reviewed every 3-5 years, or sooner if there are significant life events. In Ontario, a marriage may revoke a will and a divorce may revoke a gift to a former spouse that is made in a will.
- In Ontario, private company shares may be dealt with in a secondary will that does not need to be probated. This is a common probate planning technique used by business owners. This technique may save \$195,000<sup>1</sup> on Edward's death.
- Through a discussion and enquiry process with a **CIBC Business Transition Planning Expert**, facts and information shared identified potential tax and estate planning gaps and opportunities for the Smiths. Edward's current will distributes the private company shares to Caterina. This is a common technique used in wills to defer taxation upon death of the first spouse; however, this may not be appropriate for the Smiths. Caterina has no knowledge of the family business, the investment portfolio, or the real estate company. She is also suffering from a mental illness. Deferring taxation on the private company shares may not be the most important objective! The Smith family needs to reconsider the distribution of the shares upon death. The private company shares may be passed directly to the children, incurring immediate tax liability, or could be left in a spousal testamentary trust for the benefit of Caterina, with capable trustees controlling the trust property.
- Through further discussions held with the family, a decision is made to provide the shares of Edward's estate directly to the children, triggering a tax liability upon death.
- The will for Caterina directs her Invesco shares (FMV \$2 million) to Edward.
  - George and Nick will receive the shares from Realco and Activeco (FMV \$5.5 million each).
  - Juliana will receive the shares from Invesco (FMV \$4 million).



### Estate Distribution

ESTATE ASSET	GEORGE	NICK	JULIANA
Realco	\$2,000,000	\$2,000,000	
Activeco	\$3,500,000	\$3,500,000	
Invesco			\$4,000,000
Total	\$5,500,000	\$5,500,000	\$4,000,000

- From the table above, the values do not represent an equal 1/3 share in the value of the estate. The values do represent an equitable (equal vs. equitable) and agreed upon value from discussions held with the family.
  - Nick and George have 'sweat equity' in the business and the family, as a whole, have agreed to the above estate distribution.
- Through further enquiry, the primary home no longer meets the needs of Edward and Caterina. As a result, a discussion is held with a **CIBC Estate Planning Specialist**, and an annuity contract is purchased in order to provide a guaranteed income stream to meet their lifestyle needs.

## Step 2: Estate Liquidity

Edward has never completed a financial plan and does not know the extent of his terminal tax liability. He is not familiar with the deemed disposition and resulting tax liability if he leaves the shares to someone other than his spouse (or testamentary spousal trust). Currently, there is no life insurance in place. Given the estate distribution in the Current Structure illustration on page one, a significant tax liability will be triggered upon Edward's death; no significant tax liability is triggered upon Caterina's death<sup>2</sup>.

### Planning Recommendations

- Upon death there is a 'deemed disposition' of all property held and a resulting tax liability (with certain exceptions).
- There is an inherent capital gain in the value of the private company shares of approximately \$12 million.
- With certain post-mortem tax planning<sup>3</sup>, the tax liability upon passing can be reduced to approximately \$5.4 million<sup>4</sup>.
  - Post-mortem planning options are highly complex and a relationship with a CIBC Senior Trust and Estate Consultant can help manage the terminal tax liability.
  - Without effective post-mortem tax planning there is potential for double or even triple taxation upon death, a knowledgeable trustee is critical.
- Permanent life insurance can be used to provide the liquidity necessary to the estate in order to finance the terminal tax liability.
  - Without the use of life insurance, the estate has a liquidity need of approximately \$5.4 million, requiring assets to be sold. In many cases, the family business provides reliable sources of employment income to many family members and selling the interest in the business would not be a practical solution.
  - The investment portfolio within Invesco is to be used as the estate distribution for Juliana and is not an effective source of funds to pay the terminal tax liability.

A conversation with a CIBC Estate Planning Specialist can provide the available solutions to fund this estate liquidity need.

## Step 3: Business Transition Planning

As the founder of the family business, Edward was happy to see a plan in place that would allow the business to transition to his two sons, George and Nick.

George and Nick grow the business successfully over the next 20 years and are able to carry the family legacy envisioned by Edward. Now in their mid-50s George and Nick are contemplating their own transition plans and receive a \$30 million offer from a private equity firm for the business. George and Nick are contemplating accepting this offer. *They would have never imagined the family business would be worth this much!*

### Planning Recommendations

As George sits down for his regular meeting with his **CIBC Private Banking Advisor**, he cannot resist sharing the good news of the private equity offer! During this conversation, the Private Banking Advisor asks George several questions, including:

- Have you ever received an independent valuation for the family business?
- How are valuations for the industry determined?
- Do you know of competitors selling for a similar multiple?

These questions have George contemplating the acceptance of the initial offer and he shares this with Nick. This process is a new experience for them and the single biggest financial transaction of their lives. George and Nick decide to call the Private Banking Advisor and ask some further questions and assistance with the sale process.

The following week, George and Nick meet with **CIBC Business Transition Planning** and have a holistic conversation about the 'keep or sell' options. It is determined there is no future plans for the family business to transition to the third generation or have any employee management buyout. It is determined that a full divestiture of the family business is in the best interests of the families.

With the help of **CIBC Mid-Market Investment Bank**, Nick and George begin to determine what may be an appropriate valuation for the business and what other potential suitors may be interested. Through this process, George and Nick learn the valuation for the family business should be approximately \$40 million and a national competitor is interested in the acquisition. Also, with the help of several centres of influence, CIBC Business Transition Planning identifies a tax planning opportunity is available to complete a reorganization prior to sale. This provides a significant tax savings opportunity upon the eventual sale.

With the help of CIBC Business Transition Planning, the Smiths successfully transition their family business to the second generation and maximize after-tax value on the ultimate sale.

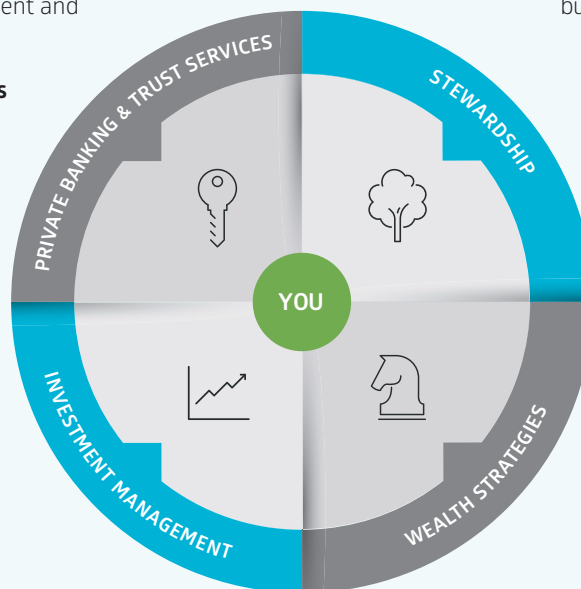
## Putting It All Together

The final step in any planning is to make sure that it matches the picture envisioned by the client. Each family's story is different, and the course of the process will vary. CIBC has the expertise to navigate the development of a transition plan.

**CIBC Private Banking Advisors** create financial strategies through single- and multi-currency solutions to meet your day-to-day banking, cash management and credit management needs.

**CIBC Senior Trust and Estate Consultants** act as your estate agent, managing all administrative responsibilities for your estate, such as executor or co-executor, power of attorney, trust administration, and wills and estate settlement services.

**CIBC Wood Gundy Investment Advisors** offer a wide variety of investment products and services and insightful and impartial advice to assist you in making informed investment decisions, according to your priorities.



**CIBC Business Transition Planning Experts** provide comprehensive and objective advice about the options business owners have with respect to what is next for you and your business.

**CIBC Mid-Market Investment Bankers** provide advice on business valuation, potential buyers and timing. When a sale is the desired exit strategy, they run a competitive, confidential process to attract offers and negotiate the terms of the transaction on your behalf.

**CIBC Estate Planning Specialists<sup>5</sup>** work with you to implement tax-efficient estate planning solutions, as well as the development and funding of a buy/sell agreement.

**Contact your CIBC advisor to learn about your business transition options. It is never too early to begin the conversation.**

<sup>1</sup> Ontario probate fee of 1.5% \* Edward corporate value of \$13,000,000.

<sup>2</sup> Edward is in good health and insurable. Due to the spousal rollover on Caterina's death, no tax is triggered.

<sup>3</sup> Assumed 'pipeline planning' (ability to trigger capital gains tax rate upon death) is not available.

<sup>4</sup> Effective 2017, highest Ontario ineligible dividend tax rate 45.3% \* inherent estate gain \$12,000,000.

<sup>5</sup> Financial Security Advisor in Québec.

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