

Plan more, pay less

Let's talk series

There are a number of tax strategies available for Canadian family business leaders — effective planning allows you to capitalize on existing opportunities.



Effective tax strategies for your family business

Findings from *Creating a lasting legacy*, the Canadian supplement to the 2012/13 Global Family Business Survey show that succession, specifically the tax implications of transitioning ownership of a business, is keeping family business leaders up at night. What's more, many of this year's respondents believe they are at a disadvantage when it comes to tax, precisely because they are a family business. That is not surprising, says Jason Safar, Canadian Private Company Services tax leader, PwC, who works exclusively with family business leaders. "For business families in particular, it's not just about the individual. An owner's personal wealth and the wealth of his or her family are directly tied to the business and so tax becomes a much more complex issue."

But does that perception of disadvantage reflect the reality? In another study recently produced by PwC*, 185 countries were examined along three metrics of taxation—the tax rate, the number of hours it takes to comply with tax regulations and the number of tax payments per year—all in terms of how small to mid-size private companies are impacted. Canada ranked eighth out of the 185 countries in terms of ease of taxation.

The reality is, there are several tax advantages to being a family business and a privately-owned Canadian company versus a foreign-controlled multinational. For example, the Income Tax Act gives Canadian private companies a preferential tax rate on the first \$500,000 of taxable income via the small business deduction. And the Scientific Research & Experimental Development tax credits are also more favourable to homegrown business. Perhaps most important for family business owners, a set of tax advantageous rules has been established to facilitate passing the family business from one generation to the next. So where is this perception coming from? Often, family businesses simply aren't aware of these tax advantages or don't structure their tax strategy in a way that will allow them to capitalize on the opportunities available. The key is to plan.

* PwC produced a study in conjunction with the World Bank called *Paying Taxes 2013: The Global Picture*

Steps to creating an effective tax strategy:

The starting point of any effective tax plan is an understanding of the long-term goals and objectives of the family. It's also the most difficult part. What are you trying to do? Is the intention that the business stay in the family for the next 100 years? Is it that the business will be sold within the next 5 to 10 years and the wealth is going to be used to further family objectives? Or will it be sold and the bulk of the wealth given to charity? Those are very different scenarios and require different plans. "Identifying these long-term goals is the hardest part of the process but also absolutely critical. Keep in mind, a tax plan is not rigid. Objectives can change over time, but you need to have an idea of where you are headed," says Safar.

The second part to the plan addresses short-term issues. How much after-tax cash do you need on an annual basis to fund lifestyle requirements? Once you have the long-term goals and the short-term needs, you can design a plan with tax efficient distribution mechanisms in place to achieve both. "For example, if the long-term goal is to give a set amount of money to your children and the rest to charity upon your death and you have that money available now, why wait until you pass to give it to charity?" says Safar. "If you give the money to charity now, we can effectively set yourself up in such a fashion that you will never have to pay tax again."

Succession planning, estate planning and the sale of a business are all a means of exiting a business. The goal in each case is to design the most tax efficient exit strategy. When it comes to succession specifically, one effective tool available to family business owners is an estate freeze, which will prevent the tax liability of a growing business from increasing. Consider this scenario: you have shares in a family business that is currently worth \$20 million. The business is growing at 10% a year. The Income Tax Act states that upon death, we are deemed to have disposed of everything at fair market value so today's \$20 million deemed disposition will become \$50 million in 10 years. The longer you hold on to those shares and the more they increase in value, the bigger the tax bill upon death. If instead, you freeze the value today at \$20 million and put the future growth in a trust to benefit the family, you've capped your tax liability. "You can also go a step further and redeem those shares to fund your lifestyle expenses, which makes your annual compensation distribution strategy a means to further limit your tax liability in the future," says Safar. "It's another way to make the short and long-term work together, which is the essence of an effective tax strategy."

"One of the key differentiators—and competitive advantages—family business owners have is their focus on the big picture," says Safar. "They are doing what they need to do to be profitable not just today but 5, 10, 15 years out. Applying that same approach to tax planning will ensure you are taking advantage of all the options available to you as a family business and give you control over the process."

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